
The dynamics of consumer credit and household indebtedness in South Africa

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Abstract

Consumer credit has become an important element of the South African economy. Given the limits on state social security payments, and the chronic absence of substantial household savings, consumer credit has come to play a vital role as a substitute for income support and/or a complement to low wages. This gives the credit market its microeconomic and welfare objectives. However, consumer credit can be a dangerous product if households allow themselves to get over-extended. Such concerns brought forth the argument for tight regulation of the credit market, resulting in the enactment of the National Credit Act (NCA) in 2006. This study explores the nuances of consumer credit use in South Africa. It draws on the consumer credit regulatory framework, participation in the consumer credit market, and the debt problems of consumers. Analysis of the NCA shows that it has the *potential* to deliver both individual and social protection from over-indebtedness (primarily through its provisions on disclosures, registration, public awareness, etc.), but desperately inadequate in its potential to alleviate consumer over-indebtedness. In practice, it is also not clear that the regulations are having a fundamental effect on consumers' decision-making as policy makers might have hoped. Analysis of variation in participation in the consumer credit market shows that participation was driven largely by life cycle consumption needs, present and expected future resources. The consumer debt-service burden was positively related to the size of the debt load and experiences of shock. While the empirical results suggest that the market was relatively secure from wide spread default losses, there are pockets of vulnerability among consumers with regard to indebtedness which might increase delinquency rates. Such consumers might benefit from reduced access to credit. Consumer debt repayment problems are, for the most part, explained by unfortunate events (shocks) that disrupt income streams, more than by excessive spending, even when controlling for debtors' creditworthiness. This suggests that even where credit is used responsibly, repayment problems might still occur. The implication is not that credit must be regulated tightly, but rather that there is a need for tighter debt relief and rehabilitation framework. The available mechanisms under NCA are not up to the task of providing meaningful relief and rehabilitation. Given the importance of shocks in debt problems and the high risk of such shocks in South Africa, this study concludes with proposals for a tightly regulated, but simple mechanism for debt discharge akin to the contemporary 'fresh start' debt relief measures.

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Chapter 1: Introduction

1.1 Background

Personal indebtedness in South Africa has grown substantially since the mid-1990s in terms of both the number of people using debt and the amounts owed. This growth has been driven in part by political and legislative factors and in part by the market. First, the major financial liberalisation drive which began in the mid-1980s (characterised by changes in the regulatory environment and an expansion of the financial infrastructure) increased the *availability of consumer credit* as lending institutions found that they could increase lending in a less constrained way than had previously been the case (Aron & Muellbauer, 2000; Prinsloo, 2002). Most notable of the changes in the regulatory environment include the 1992 and 1999 Usury Act Exemption Notices which allowed micro-lenders to charge unlimited fees for small loans which resulted in the exponential growth of the micro-lending industry coupled with extreme interest rates, inflated credit prices, and extreme consumer over-indebtedness (Hawkins, 2003). Second, the South African post-1994 socio-political transformation (characterised by some wealth redistribution, an expanding middle class and increases in the wealth of many private households) resulted in an increase in the *ability to borrow* for a larger number of South Africans (Hurwitz & Luiz, 2007).

This combination of increased *availability* of credit and *ability to borrow* resulted in large increases in private consumption relative to income, especially for new entrants into the job market (who often had little knowledge of credit dynamics and incurred high fees).¹ The consequence was that household finances became ever more fragile and private saving rates declined as more and more personal incomes were being committed to debt servicing (Aron & Muellbauer, 2000; Prinsloo, 2002).

¹Barba and Pivetti (2008:199), note in reference to the US, that while financial liberalisation reduces constraints on households, resulting in rising household indebtedness, economic rationality also rises. This thus enables a more sustainable level of household indebtedness.

This fragility is evident in aggregate statistics from Stats South Africa which inform that by November 2006, about 75 000 consumer debt default judgments² were issued every month and about 4 million South Africans had been blacklisted by credit bureaux³. It is speculated that the high household debt outstanding and a heavy debt-burden – R 680 billion and 75 per cent respectively by September 2006 – were mostly responsible for this situation. Du Plessis (2007:79-80)⁴ notes that even though interest rates had increased only marginally during this period, many South African consumers were paying as much as 360 per cent annual interest rate on short-term loans.

In addition, the fragmented consumer credit legislation (which consisted principally of the the Credit Agreements Act, Usury Act, and the Usury Exemption Notices of 1992 and 1999) had become increasingly incapable of dealing with a fast growing and modernising credit market, while exacerbating reckless credit practices and abuses (Goodwin-Groan & Kelly-Louw, 2006). In response, the government intervened by calling for a review of these credit laws and for proposals for a new credit regulatory framework. This culminated in the enactment in 2006 of the National Credit Act 34 of 2005 (hereafter, the NCA), which set out new parameters for the granting of credit, with the main objective being the prevention of consumer over-indebtedness (Goodwin-Groen & Kelly-Louw, 2006; Renke, Roestoff & Haupt, 2007; Roestoff, Haupt, Coetzee & Erasmus, 2009; Van Heerden & Boraine, 2009).

While the NCA has managed – to an important degree – to address the problem of reckless credit practices, improved credit reporting and information and reduced incidences of consumer abuse and exploitation, indebtedness levels have continued to rise in tandem with debt delinquencies. Aggregate statistics from the National Credit Regulator (NCR) show that the total value of the household debt book grew from R739 billion in January 2004 to R1.143 trillion by the end of the second quarter of 2009, with banks supplying 90 per cent of that

² Default judgment is the final disposition in a legal proceeding granted because the debtor has been in default for at least 20 business days in case of a credit agreement pursuant to the provisions of the NCA §129 and §86(9).

³ Credit bureaux keep a list of individuals with an adverse credit record including those who defaulted, referred for debt counselling, those who fail to act on debt rearrangement agreements and those with pending default judgments.

⁴ Citing Statistics South Africa data.

value (NCR, 2009).⁵ These statistics also indicate that total outstanding consumer debt⁶ increased by 52 per cent between the fourth quarter of 2007 and the fourth quarter of 2011, from R168 billion to R255 billion (at the 2007 price). The NCR further reports that the consumer debt-to-income ratio rose steadily over the period Q1 of 2004 (56%) to Q1 of 2012 (75%).⁷

While the growth in the debt book and total outstanding debt might be considered positive outcomes (as these could also suggest market growth), it is the rising trend in the debt-to-income ratio that should be worrisome. A ratio as high as 75 per cent implies that South African households were becoming dangerously leveraged with debt and hence highly sensitive to shocks. This scenario puts into question the household sector's capacity to sustain its indebtedness even in the presence of a more organised regulatory regime. The NCR statistics seem to concur with this.

These statistics indicate that 37.7% of the 16.9 million credit-active South Africans had delinquent accounts in September 2007.⁸ By December 2008, credit bureaux had records for 17.56 million credit-active consumers, 7.3 million (41.6%) of whom were delinquent. This upward trend continued into December 2010, with 46.5% (8.61 million) of the 18.5 million credit-active consumers delinquent.⁹ As of 2012 (first quarter), 9.1 million consumers were reported to have impaired credit records (consumers with accounts more than 3 months in arrears), representing 46.4 per cent of the total credit active population of 19.5 million. The proportion of consumer debt accounts that were impaired was 25 per cent, and was calculated

⁵The National Credit Regulator (2009): Consumer Credit Report | Second Quarter | June 2009. Available on: http://www.ncr.org.za/publications/Consumer%20Credit%20Report/CP%20Report_June%202009.pdf [18 January 2010].

⁶ Consumer debt comprises 'unsecured loans', 'credit facilities' and 'short term credit' (as defined by the NCA) and excludes mortgages and other secured credit.

⁷NCR's 'Research on the increase of unsecured personal loans in South Africa's credit market': final report (6 August 2012). Available on: <http://www.ncr.org.za/Annual%20Report/UPL%20Report%2047%20Final.pdf> [20/11/2012].

⁸Credit Bureaux Monitor (September 2007/ Quarter 3).

Available on: http://www.ncr.org.za/pdfs/publications/NCR_Newsletter.pdf [26 June, 2011].

⁹Credit Bureaux Monitor (December 2010/ Quarter 4).

Available on: http://www.ncr.org.za/publications/Credit_Monitor/NCR_CBM_2010Dec.pdf [26 June, 2011].

based on a reported 16.9 million accounts more than 3 months in arrears out of a total of 67.5 million.

Further reports of South Africans hopelessly over-indebted continue to reverberate in news headlines and academic as well as political rhetoric. For instance, the *Mail and Guardian* (11 Nov 2011) quoted the Planning Minister Trevor Manuel (citing Reserve Bank data) indicating that household debt was 75.9 per cent of after-tax income and that if this ratio was disaggregated one would establish that the middle classes would be in way above 100 per cent – ‘all of next year’s earnings are already spent’.¹⁰ It has even been suggested that the incessant and often violent workers’ strikes might be fueled by the unsustainable levels of debt carried by the workers. For instance, in reference to the infamous Marikana mine strike,¹¹ James (2013) notes that while some workers (e.g., the miners) are not necessarily in the lowest pay bracket, they carry unsustainable levels of debt and the manner in which their creditors ensure repayments makes life even harder. She notes debit deductions on workers’ wages by their various creditors as particularly disturbing as these often leave many of them with nothing to live on shortly after payday.

In the light of this situation, one would expect to see a proportionately large number of consumers making use of the NCA’s mechanism for the relief of consumer over-indebtedness (i.e., debt review). The Debt Counsellors Association of South Africa (DCASA) reports however, that from inception of the debt review provision in June 2007 to February 2012, only 289, 280 applications for debt review had been made.¹²

As an extra intervention, the government has offered debt information amnesties, such as the one currently in force. In February 2014, the DTI introduced a legal requirement for credit bureaux to expunge all consumers’ adverse information as of 1 April, 2014 once they

¹⁰“SA’s great debt enigma”. *Mail and Guardian News* (11 Nov 2011). Available on: <http://mg.co.za/article/2011-11-11-sas-great-debt-enigma> [20 Nov, 2013].

¹¹ In 2012 the South African police shot and killed 34 miners during a strike for higher wages by miners at the Marikana platinum mine.

¹² “Debt Review Statistics” DCASA (28 February 2012). Available on: <http://www.dcasa.co.za/library/read/?article=36&category=News> [20/11/2012].

eventually repay their bad debts or satisfy civil judgements. While such expungement might seem pro-debtor, it has a potential to destabilize the credit system.

In the first instance, information on consumers' repayment histories will be disrupted and this might lead either to poor judgment by the credit providers or increase borrowing constraints on many deserving credit applicants. Secondly, it might mean an incentive for many consumers to borrow more, even when they lack the capacity to repay, resulting in a cycle of over-indebtedness. Thirdly, such amnesties contradict the NCA's reckless lending provisions in the sense that, without this kind of consumer credit history, lenders might lose vital information necessary for ample risk assessment. One needs to take stock of the failures of the first credit amnesty in 2006. It is reported that 64 per cent of consumers affected by that amnesty had taken up further credit – which would have been a positive outcome. However, 74 per cent of these ended up in arrears – whilst 44 per cent had judgments and adverse records.¹³

On the wider spectrum, anecdotal and documentary evidence suggests that many of the undesirable practices from the old regime still exist in the market either as a result of the interaction of other laws (notably the Magistrates' Court Act 32 of 1944) or consumers' ignorance of their rights under certain credit relationships. The existence of these overlapping regulations has meant that creditors can easily circumvent the provisions of the NCA to their advantage. For instance, garnishee orders and emoluments attachment orders are still issued under the Magistrates' Court Act which directly contradict some provisions of the NCA. Evidence suggests wide ranging irregularities in the obtaining, issuing or service of these orders.

The 2008 report by the University of Pretoria Law Clinic (Haupt, Coetzee, De Villiers & Fouche, 2008) found, among others, that these orders were often falsified (most likely after the order was granted). Orders were issued from the wrong courts with creditors choosing courts practically inaccessible to the respective debtors. Also, debtors often do not get

¹³Amnesty spells trouble for credit industry: (Fin24, September 10, 2013), available on: <http://www.fin24.com/Economy/Amnesty-spells-trouble-for-credit-industry-20130909> [Accessed on November 05, 2013].

advance knowledge of a case or judgement being brought against them, often finding out only from their employers or after an attachment order has been issued. The report further notes that garnishee orders issued to public servants amounted to R1.01 billion during the 2006/2007 financial year (ibid, 14).

Empirical studies have shown that consumer debt problems tend to increase simultaneously with household debt and while researchers fail to reach consensus on whether the factors behind rising consumer debt are related to those behind consumer debt repayment problems, it is important to analyse whether indebtedness and repayment difficulties differ in relation to household and individual characteristics. Consumers can make long-term consumption plans often with enough resources to see such plans through. The occurrence of negative events might however, impair some consumers' income, making them incapable of servicing their existing financial obligations. Others might be forced to borrow more in response to rising consumption demands and thus become over-burdened with debt. As such, indebtedness and over-indebtedness will inevitably affect a proportion of the population at any time and in any economic circumstances. In the interests of both the credit industry and consumer protection, it therefore becomes imperative to have in place tight legislation and regulations that, on one hand, prevent the occurrence of over-indebtedness and on the other hand, alleviate over-indebtedness. The above disentangles, in a nutshell, the dynamics of consumer credit.

This dissertation examines the dynamics of consumer credit use in South Africa in the context of legislation to protect consumers through the prevention of, and relief from, over-indebtedness; households' participation in the consumer credit market; and the debt problems of consumers.

Given the paucity of previous studies on South Africa in this area, the present study is exploratory in nature. While it recognises the differences in contexts between South Africa and other countries, it is mainly informed by literature from other countries, especially North America and Europe, where the dynamics of debt use have been studied for many years. In particular, this study aims to:

- (1) Examine the design and implementation of South African credit legislation and its efficacy in the context of 'prevention' of consumer over-indebtedness and related problems.
- (2) Attempt to gauge the level of responsibility in the credit market prior to and after the introduction of the NCA by empirically:
 - a) Accounting for the household characteristics associated with the incidence of participation in the consumer debt market prior to the NCA.
 - b) Identifying the factors related to the level of consumer indebtedness in terms of the total outstanding and the size of debt repayment relative to income after the introduction of the NCA.
- (3) Identify the factors that are more likely to explain consumer debt repayment problems so as to:-
 - a) identify what side of the credit regulatory framework might require closer scrutiny and
 - b) provide an understanding of whether the tools provided within the regulatory framework are up to the task of solving the problems at hand.

From this, it is hoped that a further understanding of the social and economic factors involved in debt and debt repayment as well as required policy direction will be forthcoming.

1.2 Conceptualising household debt

In most developing countries, academic research and policy discussions of credit and debt usually focus on borrowing by firms and producers rather than by individual households. Households need access to credit as much as firms do. Without credit, consumers would have to accumulate the entire sale price of any items they desired. For example, it would take many years for most prospective homeowners to save up enough to purchase a home outright. The purchase of cars, private education, and even household appliances usually requires debt facilities because most consumers are not able to save large sums of money in a short time

within a background of low earnings and other daily consumption commitments. With credit, however, consumers are able to buy now and pay later — using incomes they will earn in the future. Because a household's future income path cannot be traced in its entirety, often incomes fall short of what is anticipated, thereby triggering repayment difficulties for consumers. For others, repayment difficulties might arise from misuse of the credit products either because of a lack of knowledge or sheer negligence. Then there are others yet who are boxed in by the entire system such that they are unable to access mainstream credit and are forced to borrow from underground lenders (e.g., Mashonisa) or other lenders on the fringes of legality where the costs and practices practically force borrowers into debt servitude — many South African will relate to this.

Ideally, lenders make lending decisions by inter alia, examining past debt repayment performances of applicants submitted by other lenders and published by credit bureaux. As such, borrowers must establish and maintain good credit scores to have access to the credit whenever the need arises. Furthermore, there are credit regulations which control lending and use of credit. The overarching motivation for these lies in the need to prevent consumers from getting over-burdened with more debt than they can afford to repay, and if they do, to offer them relief from debt distress.

The above statements may, of course, trivialise the topic, but they help to explain in the simplest terms the dynamics of consumer credit and consumer indebtedness. They also help to point out that, while in the most basic sense, credit (and hence debt) is an important complement for constrained or uncertain earnings, it carries certain risks both to the lender and borrower. Household debt can be divided into consumer debt and non-consumer debt.

1.2.1 Non-consumer debt

Non-consumer debt originates when households borrow for the purpose of creating or running a business, buying a house, land and other real estate (mortgages) or for home improvement. Most non-consumer debt is 'secured debt' (backed by collateral), either by the asset it was used to purchase or by another valuable asset. For example a mortgage loan is

secured by the home it helped purchase and a business loan may either be secured by the business itself or by the business owner's home.

1.2.2 Consumer debt

The present study focuses specifically on consumer debt. Consumer debt originates when households borrow for the purpose of consumption of goods or services (e.g., a computer, a car or a holiday). If a debt was incurred for the purchase of a consumer good (such as a personal computer) and is later used in one's business, it would still be considered a consumer debt. Some consumer debts may also be secured against the item purchased such that the item may be repossessed if the debtor fails to pay for example, cars and other valuable items that can be resold. In fact it is very hard to draw a line between secured and unsecured debt. Almost all credit is secured due to the fact that the lender puts trust in the borrower's future earnings and these earnings become security. Consumer credit takes different forms:

Revolving credit: Revolving credit includes credit card balances and current account overdrafts. Revolving credit types do not specify the actual amount lent to the borrower, but rather set a maximum limit and the monthly repayment amount is based on a percentage value of the total balance for that month.

Personal loans: Personal loans are not usually linked to a specific purchase or asset and not usually collateralised. For these loans, a specified amount is extended at a specified interest rate with specified maturity and a prescribed repayment plan and the size of the loan is often dependent on assessment of the repayment capacity. The amounts involved may range from very small — with a maturity of just weeks — to substantial with a maturity of a few years.

Installment debt: Installment debt, sometimes called 'retail debt', results from borrowing which is explicitly tied to the purchase of goods or services. This type of debt ranges from small-ticket items (with low or no secondhand value) without the possibility of repossession (such as clothing or foods and beverages), to big-ticket items such as expensive electronics and motor vehicles. Installment debt may be either secured by the good purchased (e.g., a vehicle) or unsecured (e.g., clothing store credit).

Informal debt: Informal debt results from borrowing from relatives, friends or community credit unions (e.g., stokvels). It may take the form of goods advanced with a promise of a future payment or money advances. There are no institutionalised terms of payment or interest rates except those mutually agreed to between the lender and borrower.

1.2.3 Over-indebtedness: concept, reason, effects and solutions

1.2.3.1 The concept of over-indebtedness

People routinely use credit cards or get cash loans to pay for things. They take out credit lines in retail stores, borrow to pay school or medical fees or buy cars on installment plans. Their success is measured on their ability to maintain agreed monthly payments. If, however, they make no payment, or pay off only a small amount (either out of sheer neglect or due to an unfortunate change in circumstances), and the debt increases every month (or almost every month), then debt starts to become a problem. The recurrent consumption needs or unforeseen events (such as job loss, health problems, or divorce), or both, might lead many individuals or households into positions where either their debts (regardless of the size) are too big relative to their incomes, or they are no longer able to meet their repayment obligations when due without substantially hurting their family or personal wellbeing (i.e., over-indebted). Consumers who find themselves in positions where they are burdened with more debts than they can afford to pay (without undue financial strain) are more likely to end up in arrears (delinquent) or in complete default. While there is a growing concern about consumer over-indebtedness around the world, there is less agreement on how it should be measured or defined. The current understanding of the problem is based largely on the level of borrowing or the extent of arrears, using indicators that take into account either the gross stock of household debt, net household liabilities, and/or the capacity to service debt (Betti, Dourmashkin, Rossi & Yin, 2007).

Recent studies identify three possible models of consumer over-indebtedness. These are based largely on the amount of debt held and the capacity to service that indebtedness or on a combination of both. These are; the administrative model, the objective or quantitative model and the subjective model (Niemi-Kiesiläinen & Henrikson, 2005; Betti et al., 2007; Disney, Bridges & Gathergood, 2008; Anderloni & Vandone, 2008).

The *administrative model* relates over-indebtedness to non-payment of debt. In this case, over-indebtedness is measured based on the official registration of defaults in a court or similar procedures such as bankruptcy or debt adjustment petitions, and or debt recovery actions registered with the courts (Niemi-Kiesiläinen & Henrikson, 2005). The problem with this kind of measure is that many people might activate alternative solutions to their problems (e.g., borrowing informally or making deeper sacrifices) and will not show up in any administrative register. Nonetheless, it can be helpful in gauging the effects of market regulations over time.

The *objective or quantitative* model uses the information on the economic situation of an agent (household or individual) to measure its relative financial burden with reference to a defined threshold considered to be the critical level of indebtedness. This measure uses ratios of total debt-to-income, debt-to-assets or repayment-to-income as measures of agents' over-indebtedness. Because it is based on observable indicators, it can inform on the consumer's current or future capacity to satisfy financial obligations and might be a better reflection of the consumer's immediate financial burden (Getter, 2003; Niemi-Kiesiläinen & Henrikson, 2005; Betti et al., 2007; Anderloni & Vandone, 2008).

The *subjective model* of over-indebtedness relates to the agents' own perception of their capacities to pay their due financial obligations without jeopardising their ongoing subsistence. Its relevance is mainly based on the recognition that because there are a variety of unobservable factors that affect consumers' financial health, individuals or households are better positioned to judge their own levels of financial pressure. Under this criterion, consumers themselves are expected to report whether their stock of debt is affecting their wellbeing or whether (or not) they are able to repay their debts when due without undue stress to their financial positions (European Consumer Debt Network, 2003).¹⁴ According to Niemi-Kiesiläinen and Henrikson (2005), studies using the subjective measure tend to find

¹⁴ The European Consumer Debt Network (ECDN) is a civil society organization dealing with "the fight against over-indebtedness and financial exclusion": <http://www.ecdn.eu/ecdn/>.

higher rates of over-indebtedness than those using the other measures, as the subjective criterion encompasses debt problems that may not otherwise be recognised.

The legal definitions of over-indebtedness in most countries are consistent in principle with one or more of these three models above. Legally defining over-indebtedness (in countries that do) is manifested in the respective country's social and economic policy objectives and such a definition is the first step in devising what the country considers to be the appropriate interventions. The South African definition of over-indebtedness (i.e. under the NCA) is mainly based on a quantitative assessment. Under the NCA, to be declared over-indebted, available information about the consumer's financial means, prospects and obligations must indicate that the consumer is or will be unable to satisfy obligations in a timely manner.¹⁵ However, an important balance is sought by the law in a sense that, should a court case arise, the consumer in question may be allowed to plead based on his/her own subjective assessment of his/her financial pressures, but then the court will have to use its discretion to decide whether the consumer should be so judged (Roestoff et al., 2009:256). Note that proof of over-indebtedness affords debtors a right to relief under the law.¹⁶

Most European countries base their definitions on the inability to pay current or approaching debts either based on observable criteria or the consumer's conviction of inability (ECDN, 2003). In the Netherlands, for example, two definitions of over-indebtedness are applied. The first takes into account the failure to pay debts within three years, giving regard to the type of debt. The second considers the quantitative level of indebtedness either in terms of the absolute value or in terms of income relative to the due or approaching financial obligations. In Belgian law the definition is based both on observable characteristics indicative of an aggravated financial situation and the manifest impossibility to meet outstanding commitments in a satisfying way. In the case of France, over-indebtedness is defined in line

¹⁵ National Credit Act (NCA) § 79(1).

¹⁶ Note that the South African credit law requires that a person found to be over-indebted by the court may benefit from the legal protection under the debt review provision. A debtor may also simply discontinue payment and wait for the lender to enforce a credit agreement in court and then plead over-indebtedness. In both cases an objective assessment of the consumer's financial health may be undertaken to verify the claims and whether the consumer deserves this legal protection (Discussed in detail in Chapter 6).

with the 1990 legislation as having a credit default petition lodged with the commissions on over-indebtedness. The German definition is mostly objective, as it relates to a long-term inability to pay based on the household's stock of debt relative to its income. As for the U.K., according Disney, Bridges and Gathergood (2008), a combination of objective indicators of the household's indebtedness levels and subjective measures of the household's ability to cope with any given level of indebtedness is used to evaluate over-indebtedness.

The American definition of over-indebtedness focuses on default or delinquency, not on subjective feelings of burden and not on the sacrifices required to meet payment obligations (Baum & Schwartz, 2005). Should, however, a case of default arise, a quantitative evaluation would be applied in order to decide on the appropriate legal decision. In Japan, both objective (obligations relative to available and expected resources) and subjective measures are accepted.¹⁷ Any suspension of payments by the debtor will also be construed as legally admissible over-indebtedness without having to apply the quantitative tests.¹⁸

1.2.3.2 Reasons for over-indebtedness

On the question of how and why people become over-indebted, empirical evidence suggests two distinctive factors: irrational behaviours (poor judgment) and unavoidable circumstances. Some people get over-committed as they attempt to keep up with the cost of living and the concurrence of misfortune. Others, in attempts to maintain or aspire to certain standards of living, make spending mistakes. Poor judgment entails credit provision practices and consumption behaviours and has been called the *market approach* (Niemi-Kiesiläinen & Henrikson, 2005). This blames consumer over-commitment on their own financial imprudence, lenders' non-disclosure of credit terms and other forms of predatory lending (e.g., Disney et al., 2008; Peterson, 2008; Anderloni & Vandone, 2010).

There is also the 'sociological' dimension to the analysis of the causes of over-indebtedness, which emphasises household situational factors (e.g., Getter, 2003; Disney et al., 2008; Keese, 2009). According to this view, consumer over-indebtedness will affect anyone at any income

¹⁷ The Bankruptcy Act, Art 15(1), § 1.

¹⁸ The Bankruptcy Act, Art 15(2), § 1.

level. Idiosyncratic and covariant shocks which often affect individuals, communities, or regions and trigger a decline in individual or family wellbeing either force them to borrow more in order to get through a bad situation, or renders them incapable of repaying their current financial obligations and their indebtedness accumulates to unmanageable levels (Draut & Silva, 2003; Dickerson, 2008; Lupica, 2009).

Often, it becomes hard to blame any single factor for consumer over-indebtedness. In practice, it is difficult to judge whether the debt problems have been the result of reckless behaviour or a desperate attempt to make ends meet as there is a definite causality between desperation and poor judgment. Also in many cases, some consumers might be living on the edge with huge debts to the degree that the occurrence of a shock might just push them over that edge (Disney et al., 2008). Contemporary legislators around the world have therefore realised that to deal effectively with the consumer over-indebtedness problem, two forms of regulations are necessary: preventive (pre-consumption) and alleviative (post-consumption) regulations. The preventive regulatory tools tackle poor judgment and irrational market behaviours while the alleviative tools provide consumption insurance when misfortunes occur.

1.2.3.3 The effects of over-indebtedness

The social and economic effects of over-indebtedness are far-reaching and the associated costs may not necessarily be paid by the debtor or household in question, but other members of society might be affected too. Besides being a serious economic problem, empirical studies have found over-indebtedness to be a psychological problem as well, often leading to low social economic status and exclusion from social settings (Munster, Ruger, Ochsmann, Letzel & Toschke, 2009; Lupica, 2009; Rueger, Schneider, Zier, Letzel & Muenster, 2011).

Over-indebted families may often be forced to cut down their consumption either as a way of making an extra sacrifice or because they are unable to qualify for more credit in the market place. Others may be forced to employ the services of unscrupulous and dangerous underground lenders because they no longer qualify for mainstream credit due to their bad records (Rueger et al., 2011). Over-indebted individuals may be found to descend into lives of hopelessness, with very little incentive to work more than is needed for survival (Niemi-

Kiesiläinen & Henrikson, 2005; Steiger, 2006). Consumer over-indebtedness often also presents financial costs to lenders (e.g., debt collection costs or the costs associated with default losses) while a large portion is paid by the welfare state or the economy (Niemi-Kiesiläinen & Henrikson, 2005). For example, in terms of falling productivity, health-related costs and rising welfare benefits while large scale losses to lending institutions due to debtors' defaults may jeopardise the credit system and with it, employment and incomes, as was witnessed in the recent financial crisis.

1.2.3.4 Solutions to over-indebtedness

Because over-indebtedness can be traced to many factors, a number of different measures may be implemented by the government or the households themselves. In the case of individual households, it needs to be noted that different people deal with financial problems differently. Some make greater sacrifices and save; others might take on extra work or borrow from friends and family while some deny themselves certain necessities until their situations stabilise. There are also informal group saving and insurance schemes.

In the case of government, regulatory measures for the credit industry may be implemented, targeting both the causes and effects of consumer over-indebtedness (Subsection 1.3.2). Other measures can also have a positive effect on consumer over-indebtedness, including social policies designed to afford consumers strong safety nets that shield them from a deterioration in their welfare. Social security programmes, such as unemployment benefits, and accessible public health care can have a remarkable effect on debt problems as these have a potential to prevent households from falling into a debt-spiral during tough financial times (Niemi-Kiesiläinen & Henrikson, 2005). The design of these solutions will, of course, be largely dependent on local social policy needs and the variances in the socio-economic situation. The current theoretical issues underpinning the importance and pitfalls of credit and debt have also played an important role in the design of the contemporary solution to consumer debt problems.

In this dissertation the terms over-indebtedness, debt repayment problems, delinquency or insolvency will be used interchangeably to refer to a situation in which debtors are no longer

able to meet their debt obligations as they fall due (e.g., Niemi-Kiesiläinen & Henrikson, 2005; Betti, et al., 2007; Dickerson, 2008; Gathergood, 2012).

1.3 Theoretical Issues about debt use

While many factors influencing personal indebtedness have been proposed in the literature, no clear conceptual model which integrates these has yet emerged, as studies tend to draw on a few factors depending on the academic discipline of the researcher in question according to Livingstone and Lunt (1992). Nonetheless, a common understanding can be found is the sense that on the one hand, borrowing represents a household's use of future income to pay for current consumption –various reasons are expected to lead to this decision. On the other hand, lending represents a firm's trust in the viability of the household's future resources. In between this relationship is the government. The government designs regulations to protect credit consumers by preventing unpredictable behaviors by one or both parties as well as to protect welfare gains that might result from this relationship. Understanding the dynamics of consumer debt requires answers to such questions as to how people get into debt; whether the deeply indebted people are different from those with less debt; and what the appropriate forms of regulation that can be implemented without hurting the credit supply are.

1.3.1 Participation in the debt market

Many people are in debt – some are far more indebted than others – and they know (to some extent) how they got there. The narrowest meaning of getting into debt is 'spending money that you do not have'. This is done either voluntarily (buy new furniture, buy movie tickets with your credit card) or involuntarily (a family member is taken ill or worse, you lose your job yet your dependents need to be fed). Getting into debt is both a function of urgent need and creditworthiness. There are also social and cultural pressures that impel some people to borrow especially in case of conspicuous goods. Some households or individuals are forced to borrow because of factors beyond their control while others borrow because they have access to credit given their relatively better level of resources (i.e. are favoured by credit providers). Such factors should also clarify how deeply people can get into debt. A number of theories have been proposed but for the purpose of this study, the life-cycle theory of consumption and the ability and willingness to consume are more informative.

1.3.1.1 The life-cycle theory

The demand for debt is a function of the household's underlying plan for consumption and its deviation from incomes and expenditures (Bryant, 1990; Ludvigson, 1999; Bertola & Hochguertel, 2007). According to Ando and Modigliani's 1963 life-cycle theory, consumers try to maximise utility from lifetime consumption: in the sense that they tailor their consumption patterns to their needs at different stages of the lifecycle independently of their incomes at each stage, by building up assets (saving) and running down assets (borrowing) (Gourinchas & Parker, 2002; Deaton, 2005; Bertola & Hochguertel, 2007). Consumption needs can be affected by household demographic characteristics such as age, household size or marital status (Godwin, 1998; Kim & DeVaney, 2001). Consumers can also under a budget constraint, make borrowing decisions to maximise utility (Bryant, 1990).

Because the life-cycle theory does not allow for any miscalculation or imprecise assessment of vital information (Bryant, 1990), consumers are prone to suboptimal consumption decisions. The idea of optimising consumers has been criticised on grounds that: consumers are boundedly rational (Conlisk, 1996; Camerer, 1998; Kahneman, 2003), inherently impatient and lack the kind of self-control needed to follow the saving pattern that would be required to solve the optimisation problem presented by the life-cycle point of view. In addition, the uncertainties regarding future incomes mean that a positive demand for credit should be expected in times when current income and liquid assets (accumulated by past savings) fall short of consumption wishes and the opposite should be expected to hold true (Shefrin & Thaler, 1988; Thaler, 1994; Graham & Isaac, 2002).

1.3.1.2 Ability and willingness to consume

Another factor affecting consumer debt use is the lenders' selection criteria (or creditworthiness) which translates into households' ability and sometimes willingness to consume. According to the *ability and willingness to consume* exposition (Katona, 1960), consumption behaviours are determined by consumer sentiments and ability to access consumption tools. Ability to borrow is primarily represented by objective conditions such as income and other resources that convince the lender that a particular debtor will be able to repay the debt when it comes due. The distribution of debt is thus likely to be concentrated

in specific households considered by lenders to be less risky (Roos, 2008; Easaw & Ghoshray, 2008). The *willingness* to use credit is informed by subjective variables such as attitudes towards borrowing and financial expectations while the ability to borrow might increase the willingness to borrow (Chien & Devaney, 2001; Godwin 1997; Zhu & Meeks, 1994; Kent, Ossolinski & Willard, 2007).

In a nutshell, participation in the consumer debt market is a function of a household's position in the lifecycle (which dictates the household's consumption needs), the capacity to satisfy debt supply conditions and willingness to use future incomes for current consumption.

1.3.1.3 Debt repayment problems

Debt entails repayment and debts are generally repaid. However, for a number of reasons, some debtors often find themselves unable to pay their debts. Although the relative risks of default can be identified and managed to an extent, the possibility of default can be seen as an inevitable feature of the credit phenomenon (Viimsalu, 2010). In the analysis of non-mortgage consumer debt, debt repayment performance is closely related to the cash-flow theory of defaults (also called the ability-to-pay) which is based on the assumption that decisions to stop payments are not strategic and that consumers are not simply being dishonest when they default on their obligation. Instead, consumers will avoid arrears as long as their income flows are sufficient to cover their debt payments without an undue financial burden (Jackson & Kaserman, 1980; Alfaro, Gallardo & Stein, 2010). A negative transitory income and the size of required monthly repayment will thus have a greater effect on the repayment performance (Weagley, 1988).

The size of the repayment burden and the ensuing repayment performance can be affected by consumption behaviours and other defective market practices (Niemi-Kiesiläinen & Henrikson, 2005). For instance, consumers might borrow without regard to the costs or possible consequences thereof and their borrowing might exceed their capacities to repay on time (Anderloni & Vandone, 2010). Other consumers might borrow within their means, but unfortunate events that might follow the borrowing (e.g., job losses, health problems, or

divorce) might erode their capacities to continue servicing their financial obligations (Dickerson, 2008).

1.3.2 Credit legislation: prevention and alleviation

The purpose of consumer credit legislation has traditionally been to regulate the substance and form of consumer credit arrangements, and the conduct of parties participating in those arrangements. The democratisation of credit and its unintended consequence of growing consumer over-indebtedness have led to a re-examination of the importance of having consumer credit laws. On the basis of social (and to some extent, economic) considerations, contemporary legislators have decided that it is necessary to develop solutions that (1) address the causes of consumer over-indebtedness – because over-indebtedness can result from irrational credit market behaviours – and (2) those that attempt to alleviate the problem – because over-indebtedness can also result from unanticipated events beyond the consumer and the credit providers' control. Ideally in both cases, consumer protection is the overriding principle.

It is well documented that in South Africa the current consumer credit law (NCA) was introduced because of distrust of financial institutions, which were blamed for perpetuating wide-ranging exploitative practices especially targeting the lower-income to middle-income markets that are generally less financially sophisticated (e.g., DTI, 2004b; Goodwin-Groen & Kelly-Louw, 2006; Woker, 2010). Many consumers were thought to have been coaxed into accepting credit at exploitative terms without regard to their capacities to repay. They were incurring excessive debt with arbitrary standards for pursuit of repayment via often brutal debt collection methods or repossession of assets for the many who experienced repayment difficulties. In making the case for the implementation of the current credit legislation, policy analysts motivated that (1) there was a considerable imbalance of power between consumers and credit providers, consumer education levels were low, consumers were poorly informed about their rights and unable to enforce such rights; (2) commission-driven agents, deceptive marketing practices and weak disclosure were causing consumers to enter into unaffordable credit contracts which resulted in extreme financial hardships; and (3), just as in most modern states, it was necessary to implement a more prescriptive

consumer credit legislation with a more extensive enforcement framework than what is usual in the regulation of other sections of the financial market (DTI, 2004b:6-7). As a result, the NCA was introduced with extensive tools to prevent consumer over-indebtedness (pre-contractual) and some modest alleviative tools (post-contractual).

1.3.2.1 Prevention of over-indebtedness

To the extent that a consumer credit law is concerned with the causes of over-indebtedness, the primary emphasis of enforcement is aimed at influencing responsible practices and consumer awareness. The legal measures to prevent consumer over-indebtedness include regulatory tools to deter reckless credit granting, provide consumers with means to make better informed decisions, and to educate consumers on the pitfalls of debt accumulation. Such efforts are essentially pre-contractual in nature (Renke, 2011), aiming to prevent consumers from accepting credit they might not be able to afford and to remove incentives for consumer deception by lenders. While the finer details and requirements vary across jurisdictions, the direct preventive tools implemented by contemporary consumer credit regulatory regimes (including South Africa's NCA) are provisions on information sharing and credit information disclosure, illegalising predatory lending; consumer education and public awareness (Reifner & Herwig, 2003; Renke et al., 2006).

The contemporary disclosure statutes take two forms. There is the 'truth-in-lending' style credit terms disclosure which allow consumers to compare more readily the various credit terms available to them and protect them against inaccurate and unfair credit billing (Furletti, 2003; Willis, 2006; Stango & Zinman, 2011). The second form relates to inter-firm disclosure of borrower characteristics and indebtedness to aid credit providers' in risk assessment (Jappelli & Pagano, 2005; Hauswald & Marquez, 2006; Van Tassel, 2011). This in effect ties in with the creation of efficient and effective credit bureaux and a central registry of obligations.

The legal provisions that illegalise reckless and predatory lending also prevent over-indebtedness by removing incentives for lenders to lend more than consumers can afford. These are also largely dependent on effective information disclosure because lenders will

have to depend on the information exchanged to assess the consumer's ability to repay. With regards to consumer education, the overarching aim is to remove the power imbalances that might exist between lenders and consumers and offer consumers the power to make their own decisions with full knowledge of the facts and the consequences of their decisions.

Concisely, preventive regulatory tools are meant to prevent consumers from making unfavourable consumption choices and therefore, are meant to regulate the environment and the actions that precede the signing of the credit contract (Renke, 2011). Beyond this, another set of credit regulations takes over – if debt problems should arise.

1.3.2.2 Relief from over-indebtedness

In a world where negative (often unexpected) events regularly occur to both household resources and basic expenditure requirements, even the presence of the best over-indebtedness preventive measures will not eradicate consumer debt problems. A number of mechanisms to protect the unfortunate consumers who find themselves in financial trouble might be in place, including self-insurance through saving, state insurance through social welfare benefits or informal insurance through intergenerational transfers or community support (Betti et al., 2007). Unfortunately, such mechanisms tend to be inadequate in accommodating the impact of substantive negative shocks – especially in the context of the developing world. Even where credit is used responsibly, consumers might still find themselves in a situation of severe over-indebtedness if they or their households suffer unfortunate events. For this reason, regulatory mechanisms to alleviate consumer over-indebtedness become necessary.

Alleviative measures relate to the various curative *ex post* responses to debt repayment problems (post-contractual), such as debt management and restructuring schemes, with the possibility of discharging part of the debt (Anderloni & Vandone, 2010). The necessity to revive the financial health and economic productivity of over-indebted consumers (either as a right or favour) is at the forefront of the rationale behind the contemporary over-indebtedness legal relief measures. Modern consumer protection standards generally suggest that when there are no possibilities for consumers to meet part or all of their financial

obligations in the future, there should be a legal framework to relieve them from their debt burdens so that they can continue to contribute positively to the economy (Gerhardt, 2009). Such a framework should allow for the payment of a portion of the debt on manageable terms – and then relieve the debtors of the portion they are unable to pay (Tabb, 2005). This has been called the ‘fresh start’ doctrine, the standard bearer for contemporary legal interventions to relieve consumer over-indebtedness (Niemi-Kiesiläinen & Henrikson, 2005; Livshits, MacGee & Tertilt, 2007; Dickerson, 2008). In South Africa, relief and the rehabilitation of natural persons are provided for under the debt review and restructuring provisions of the NCA.

In summary, provisions for the relief and rehabilitation of over-indebtedness would allow over-indebted consumers – whose debt problems are, in principle, not self-inflicted by recklessness – to attempt to repay some of their debt (to the extent that they financially are able to) and then be discharged from the rest so that they can have a fresh start and become productive members of the economy again. While the objectives and motivations for implementing legal debt relief measures are largely similar across most countries (Dickerson, 2008), the requirements vary a great deal and the outcomes of the relief procedures are greatly variable.

1.3.2.3 Recent developments: European Union Guidelines

On 23 April 2008, the EU introduced the 2008 Consumer Credit Directive (hereafter CCD 2008) in order to harmonise certain aspects of the laws, regulations and administrative procedures of the Member States concerning consumer credit agreements (Art. 1).¹⁹ The previous Council Directive of 1986²⁰ demanded minimum harmonisation, which resulted in some Member States adopting their own higher standards. A new Directive was, therefore, necessary. The 2008 Directive was adopted after six years of discussion amongst the interested parties, with its provisions expected to be transposed into national laws of Member

¹⁹ No 2008/48/EC of the European Parliament and the Council of the European Union of 2008-04-23 (Reviewed in June 2013).

²⁰ Council Directive 87/102/EEC of 1986-12-22 which laid down rules at Community level concerning credit agreements.

States by June 2010.²¹ In line with this dissertation, only a few of the general guidelines are presented here, in particular, those that enable consumers to make informed choices as well as maintaining responsible market behaviours.

The Directive emphasised pre-contractual information and disclosure as an important preventive solution for over-indebtedness. The CCD 2008 inter alia requires that consumers are protected against unfair or misleading practices, in particular with respect to the disclosure of information by creditors. There are specific provisions on advertising credit offers, full details concerning credit agreements as well as for certain items of standard information to be provided to consumers to enable them to compare different offers and make their decisions in full knowledge of the facts. The Directive requires that such information be given in a clear, concise and prominent way so that consumers may go and consider the information prior to the conclusion of the agreement. Such information should include the total cost of the credit; duration of the credit agreement; the borrowing rate; the annual percentage rate and the conditions and procedure for terminating the credit agreement.²² Guideline 23 relaxes the information requirements on specific types of credit agreements, taking into account the specific character of the agreement but ensuring an adequate level of consumer protection without placing an excessive burden on creditors.

Guidelines 26-29 emphasise upholding responsible market behaviours. Member States are directed to take appropriate measures to promote responsible practices during all phases of the credit relationship, taking into account the specific features of their credit market. For instance, providing information to, and the education of, consumers, including warnings about the risks attached to default and over-indebtedness. In the expanding credit market, in particular, serious attention should be given to enforcing responsible lending and thorough assessment of creditworthiness. This should entail, serious supervision to avoid irresponsible behaviour and determining the necessary sanctions in the event of non-compliance. Creditors should bear the responsibility of checking individually the creditworthiness of the consumers

²¹ Consumer Credit Directive: Available on: <http://www.eurofinas.org/index.php?page=ccd> [4 Sept, 2013].

²² Guideline 18 to 25. Credit intermediaries are also bound by these information provisions.

whilst, consumers should also act with prudence and respect their contractual obligations. Other than the pre-contractual information, consumers may still need more assistance to make decisions. Member States must therefore ensure that creditors provide additional assistance to consumers to enable them to decide which deals are most appropriate for their needs and financial situation.

Guidelines 31 and 32 call for full transparency before, during and after the credit agreement. The CCD 2008 provides that credit agreements should contain all necessary information in a clear and concise manner to enable the consumers to recognise their rights and obligations under the agreement. The consumer should be provided with information concerning the borrowing rate both at the pre-contractual stage and when the credit agreement is concluded and during the contractual relationship, the consumer should further be informed of changes to the variable borrowing rate and changes to the payments caused thereby.

While the CCD 2008 intended to establish common rules with regards to the conducts of the credit market actors, member states remain free to maintain or introduce rules at national level with regard to certain aspects as specified.

1.4 Contributions

The problems of debt and repayment in the rapidly developing consumer credit industry in South Africa mirror those across most of the developed world. As long as firms continue to lend there will always be some consumers who will fail to fulfil their obligations, regardless of the best efforts of underwriters and legislators. Repayment problems on a wider scale have implications for the health of the banking sectors' profits which may (in turn) adversely affect household wellbeing in terms of higher interest rates and tighter credit constraints or, at worst, widespread collapses as evidenced from the recent financial crisis. Understanding these dynamics is crucial to ongoing policy debates especially with regards to consumer protection in the credit market.

Lending institutions need to keep reinventing their credit risk management tools because it is impossible to know with certainty which consumers will eventually become delinquent. Lenders could employ this information to make better lending decisions and possibly reduce

the probability of default losses. With improved knowledge about how debt use and indebtedness levels differ across households or individuals of different characteristics, consumer educators could help consumers to better manage their finances. This could also be important to regulators in reforming guidelines for consumer credit use on lenders and consumers.

Specifically, this dissertation contributes to the literature on consumer credit and indebtedness by showing that consumer over-indebtedness and its associated outcomes are affected by factors more complex than the fact that consumers and lenders are behaving recklessly. In effect, the dissertation challenges the current credit regulatory regime's central premise of reckless lending and borrowing and argues that the failure of the designers of the credit legislation to look beyond market behaviours created an imbalance in the regulatory framework. It is this dissertation's submission that the current consumer credit Act over-emphasises the prevention of over-indebtedness at the expense of relief and alleviation of the problem. The dissertation pinpoints some areas in the regulatory framework that require attention.

This dissertation begins by analysing the design and implementation of the South African National Credit Act in the context of prevention and protection of consumers from over-indebtedness and related financial problems – including the legislative history of the Act, and stakeholders' views on the issues of substantive disagreement during debates in the committee. Most importantly the study attempts to highlight gaps in legislation which should benefit future regulatory reforms. Particular attention is given to the credit law's underlying values of individual and social protection. The analysis focuses primarily on information disclosure to aid individual borrowers, provisions that activate lender liability for irresponsible lending, the registration of market actors, and consumer education. These are noted as the key components of the Act which reflect the Act's broad objective of prevention of consumer over-indebtedness. A discussion of measures aimed at the alleviation of debt problems already incurred falls outside the scope of this section and is covered in a separate chapter. The chapter uses public records, particularly debates and hearings in the

parliamentary Portfolio Committee, as well as information gleaned from in-depth interviews of some credit market stakeholders and the secondary literature.

It appears that the NCA is a great improvement on the credit laws that preceded it and has had a positive effect on consumer protection. However, evidence suggests that over-indebtedness remains widespread. This, perhaps, calls for a comprehensive review of particular sections of the NCA.

An empirical analysis of the factors associated with participation in the consumer debt market prior to the introduction of the NCA is presented in Chapter 3. The main question thus answered relates to the type of household more likely to use consumer debt prior to the introduction of the NCA. Its main aim is to investigate credit behaviours of the time (and whether these were consistent with the central premises of the current regulatory regime) and the importance of debt in households' welfare. In essence, the chapter examines two assumptions. First, lenders were acting rationally to protect themselves from default losses and therefore the 'ability to borrow' was an important determinant of credit market participation. Second, compelling household budgetary difficulties were an important driver for debt use. The results indicate that both factors were important, suggesting that in spite of widespread reports of recklessness, the credit market exhibited a fair degree of normalcy. These findings are consistent with the life-cycle model of consumption.

Chapter 4 presents an empirical analysis of the factors relevant in the level of household indebtedness in terms of (1) the total outstanding consumer debt and (2) the monthly consumer debt service-burden. The results indicate that the debt service-burden is positively related to situational factors that exert financial pressure on the household and the size of the absolute debt held, while the total debt load is influenced by the level of income and other resources that influence lenders' decisions to lend. Over all the results seem to suggest that the market is less exposed to wide scale default losses as only a small minority of debtors exhibited extreme debt service-burdens. The data limitations made it impossible to determine whether the NCA was influencing this situation or not.

Chapter 5 examines what kind of consumer is at risk of defaulting on a consumer debt. It focuses on the inability to repay consumer debt when the household is hit by an adverse event (e.g., loss of employment) or due to chronically excessive spending that makes consumers financially overextended. The results indicate that debt delinquencies are better explained by adverse (often unanticipated) changes in family situations than excessive spending. The inference is that, even in the absence of irresponsibly borrowing or lending practices, some consumers will be forced to abandon their financial obligations due to unfortunate social circumstances beyond their control. As such, while the government's emphasis on prevention of consumer over-indebtedness is commendable, it might not eradicate the problems of defaulting on payments and, therefore, it is necessary to review other legal interventions to consumer debt problems.

Given the results in Chapter 5, and the fact that shocks are very widespread and often cause long-term adverse effects to the victims in a developing world context such as South Africa, strong and effective regulatory measures for consumer debt relief and rehabilitation are required as much here as they are in the developed world where such measures already exist. With this background in mind inclusion of a Chapter 6 was deemed necessary.

Chapter 6, thus, analyses the South African approaches to consumer debt relief and rehabilitation against a background of recent developments in the developed world. This is necessary to provide an understanding of why the current South African approach is not up to the task of providing meaningful relief and rehabilitation of consumer over-indebtedness. This contribution proposes thorough review of these measures in favour of tighter provisions that can offer a simple, straightforward mechanism for debt discharge akin to the 'fresh start' regulatory intervention. The summary and conclusions are presented in Chapter 7.

Chapter 2: The South African consumer credit legislation

Abstract

The National Credit Act 34 of 2005 (NCA) – passed in March 2006 and came into full operation on 1 June 2007 – was introduced in response to the perceived wide-ranging consumer abuses and irresponsible market practices reported to be a result of weak, outdated and fragmented consumer credit laws. As such, one of the purposes of this Act is to protect credit consumers from over-indebtedness by aiding consumers' decision making, and addressing imbalances in the negotiating power between consumers and credit providers with tools to inter alia, enforce disclosure and information sharing, prevent reckless lending, and improve consumer education. This chapter analyses the formulation and implementation of the NCA in the context of the prevention of consumer over-indebtedness. Particular attention is paid to the Act's provisions that might have a direct influence on the application for and acceptance of debt – particularly those that affect consumers' pre-contractual decision making. Provisions to alleviate over-indebtedness are outside the scope of this chapter. This study finds that the Act has the potential to deliver both individual protection (notably through its requirements on disclosures and fair contracting) and social protection (through registration of the main players, education and public awareness, etc.,) albeit with major shortcomings, including inadequacies in compliance monitoring. The study is based principally on information available in the literature and public record, particularly debates and hearings in the Parliamentary Portfolio Committee.

Key words: Consumer protection; NCA; NCR; Over-indebtedness; Prevention

2.1 Introduction

The purposes of this Act are to ...protect consumers, by...encouraging responsible borrowing, avoidance of over-indebtedness...improving consumer credit information and reporting... (NCA 2005 (SA), Cpt 1)²³.

The National Credit Act (hereinafter the NCA) which came into full effect on 1 June 2007 was a result of a long consultative process. The order of events leading up to its promulgation essentially starts with the 1992 South African Law Reform Commission's (SALRC) review of the now repealed Usury Act 73 of 1968 which highlighted far-reaching weaknesses in the credit law. Subsequent reports commented further on the weaknesses of this and other laws that governed credit in the country and proposed a complete overhaul of the entire credit legislation. Such reports included the 1999 National Small Business Regulatory Review by Ntsika Enterprises Promotion Agency and Hans Falkena's 2001 Task Group's investigation into Small and Medium Enterprise (SME) finance.

Acting on these reports and the proposals therein, the Department of

The chronology of the policy formulation

Reviewing the credit laws of the time

- 1992: The SALRC review of the Usury Act
- 1999: The National Small Business Regulatory Review
- 2001: Policy Board for Financial Services investigation into SME finance

Executive action

- March 2002: DTI appoints a Committee to make proposals on the policy direction
- June 2003: Committee consults with different actors
- February 2004: The Committee reports to DTI
- August 2004: The Policy Framework for Consumer Credit published by DTI; feedback requested
- October 19-20, 2004: Workshop to inform the Bill
- May 2005: Feedbacks integrated into the draft credit Bill

Legislative action

- 8 June 2005: The Bill is presented to parliament
- 11 July 2005: A notice for comment published
- July - August 2005: Public hearings held in the Portfolio Committee
- September 2005: Deliberations held in the Portfolio Committee
- October 2005: Final proposed amendments to the Bill adopted
- 15 March, 2006: The Bill is signed into law by the president

²³ NCA 2005 (SA). National Credit Act 34 of 2005, Government Gazette 28619 (15 March 2006).

Trade and Industry (DTI) established a Technical Committee (hereinafter the Committee) to undertake a review of the legislation impacting on credit and to make proposals for a new regulatory framework for consumer credit. The Committee drew on the above reports and several others, held discussions with government officials, industry representatives and academics for opinions and recommendations on the direction of the new credit policy. These opinions and recommendations became the subject of the DTI's policy document (*A policy framework for consumer credit*)²⁴ published in 2004. This policy document was discussed by stakeholders from national and provincial government, labour, business and community representatives. In May 2005, the feedbacks received on the document were integrated into the draft National Credit Bill which was presented to Parliament and parliamentary committees for a formal briefing in June 2005. A number of public hearings and deliberations were held in the Trade and Industry Parliamentary Portfolio Committee between August and September 2005. These were followed by deliberations, culminating into the Bill being signed into law by the President on 15 March, 2006 as the National Credit Act 34 of 2005 with all its sections coming into force on 1 June 2007.²⁵

This chapter provides a detailed analysis of the formulation of this Act. The main components of the Act are then analysed without being a comprehensive and detailed discussion of all the provisions in it. One of the main contributions to the literature is the finding that while the formulation of the NCA was a long elaborate process, the bill's time in the Parliamentary Portfolio Committee did not represent a typical exercise of legislative consideration of such an important piece of consumer protection legislation. Such a contention is borne out by two factors. First, the fact that submissions and debates in the portfolio committee did not result in any substantive amendments and second, the politicians on committee neither took the DTI to task on the content or form of the draft law nor expressed any meaningful reservations

²⁴ Hereinafter, 'The policy framework for consumer credit document' or DTI (2004b).

²⁵ There were various dates of commencement for different sections of the Act:

1 Jun 2006 for *sections* 1-11 (chapter 1); 12-25, 35-38 (chapter 2, part A, C & D); 39-59 (chapter 3); 69, 73, 134-142 (chapter 7), 153-162, 164-170 (chapter 8, excluding s 163), 171-173 (chapter 9), and schedule 1-3; 1 Sep 2006 for *sections* 26-34 (chapter 2, part B), 67-68, 70 and 72; and 1 Jun 2007 for *sections* 60-66 (chapter 4, part A), 71, 74-88 (chapter 4, part C and D), 89-123 (chapter 5), 124-133 (chapter 6), and 163.

on any of its provisions. Perhaps a lost opportunity to make the law more context based or, perhaps the DTI was right given the contemporary developments in this field.

The components of the NCA analysed in this chapter are those that are central to the Act's objective of preventing consumer over-indebtedness. In particular, this analysis aims to examine whether these tools are up to the challenge of preventing consumer over-indebtedness. These include the National Credit Regulator (NCR); the disclosure requirements and information sharing; reckless lending and over-indebtedness. The study finds that while the Act faced heavy opposition from credit providers and harbours a number of shortcomings, it offers modern tools capable of improving market responsibility and consumers' bargaining power. Contrarily, it might also provide incentives for some consumers to over-extend themselves.

The Act is meant to be read with the regulations promulgated in terms thereof (National Credit Regulations consists of 76 regulations grouped under ten chapters).²⁶ Goodwin-Groen and Kelly-Louw (2006) explain that these regulations are complementary to their enabling sections in the NCA. They provide for matters not specifically dealt with by the sections of the Act.

The chapter uses public records particularly debates and hearings in the Parliamentary Portfolio Committee as well as information gleaned from in-depth semi structured interviews of 15 credit market stakeholders and the secondary literature. The chapter proceeds with a brief overview of the NCA. This is followed by the background to the NCA, including the legislative history, as well as stakeholders' views on the issues of substantive disagreement during debates in the Portfolio Committee. This is followed by an analysis of the key components of the Act related to the prevention of consumer over-indebtedness and how they reflected both the struggle in drafting the legislation and its stated objectives.

²⁶ The National Credit Regulations are published in Government Gazette 28864 of 31 May 2006, Regulation Gazette No. 8477: R489.

2.2 The National Credit Act: an overview

... to promote responsible credit granting and use and for that purpose to prohibit reckless credit granting; to provide for debt re-organisation in cases of over-indebtedness; to regulate credit information; ... to promote a consistent enforcement framework relating to consumer credit; to establish the National Credit Regulator... (NCA 2005 (SA)).²⁷

Since the advent of democracy in 1994, the South African government has been active in reviewing regulations to protect consumers. This has culminated in the passing of two major consolidated consumer protection legislations: the Consumer Protection Act, No. 68 of 2008 ([Appendix A](#)) and the National Credit Act No. 34 of 2005 (NCA).

The NCA codified the South African consumer credit laws which were scattered in the now repealed Usury Act of 1968, Credit Agreement Act of 1980 and the Exemption Notices to the Usury Act; 1992 and 1999. The new law provided for a comprehensive regulation of the consumer credit industry. Its promulgation was the culmination of an extended period of discussion and research during which it was established that the existing legislative environment was incapable of addressing contemporary concerns in a credit market that was growing in scale and complexity. It was widely argued that reckless lending, uninformed use of credit due to non-disclosure of credit terms and costs, and asymmetric information intended at consumer exploitations were leading to an unprecedented growth in consumer over-indebtedness, hence the need to reverse the situation (DTI, 2004b).

The NCA applies to all credit agreements²⁸ between parties ‘dealing at arm’s length and made within, or having an effect within the republic’ (NCA 2005 (SA) §.4).²⁹ The Act

²⁷ The general objectives of the NCA as stated in its preamble.

²⁸ According to the Act an agreement becomes a *Credit agreements* if it is;

A *Credit facility*; where supply of goods or services or payment of an amount to a consumer and where repayment is deferred and a charge, fee or interest is payable to the credit provider (section 8 (3)),

A *Credit transaction*; where an agreement regardless of its form not contemplated in section 8(2) including but not limited to; Pawn or discount transaction; incidental credit agreement; installment agreement; mortgage agreement or secured loan; lease (section 8(4)).

A *Credit guarantee* (section 8(5); where a person undertakes to satisfy upon demand any obligation of another consumer in terms of sections 8 (3) and (4), but excluding agreements contemplated in (2).

²⁹ Exceptions apply by ministerial order (Section 4(1) d, read with National credit regulations (section 2).

introduced the National Credit Regulator (NCR), an institution responsible for the regulation of the consumer credit industry (§12-25) and tasked with supervisory, administrative and regulatory functions as well as being a collector, custodian and disseminator of information (§16 & 18). Other functions of the NCR include the registration of credit providers,³⁰ credit bureaux and debt counsellors³¹ as well as investigation of complaints and ensuring enforcement of the Act (§15). The Act also introduced the National Consumer Tribunal (NCT) to deal with adjudication of matters relating to applications made in terms of the Act, prohibited conduct and devising solutions to resolve disputes and granting orders for costs (§26-34).³²

All credit providers with outstanding agreements beyond ministerial prescribed thresholds – in terms of either number or aggregate value – must, in terms of the NCA, register. The Act applies even where the credit provider is not registered, although failure to register is illegal and may render credit agreements entered null and void. In terms of consumer protection, the application of the Act is limited to juristic persons³³ with assets or turnover not exceeding a certain threshold³⁴ or where the transaction is a mortgage agreement. To avoid being retrospective, the Act has very limited application to agreements concluded before 1 June 2007, as these are subject to the legislation in force at the time. The Act does not apply to insurance policies, immovable property leases and transactions between a stokvel and its members (§ 8 (2) a-c).

The NCA provides for ‘incidental’ credit agreements³⁵ but with minimal application. In such arrangements, the service providers need not register with the NCR. Other credit agreements

³⁰Credit providers must register if they have at least 100 credit agreements (excluding incidental credit agreements) Section 40 (1)a.

³¹NCA §14 & 40, read with National Credit Regulations (Sections 4-9).

³² Read with (section 27 & 141-150).

³³ The Act defines a juristic person as including; ‘a partnership, association or other body of persons, corporate or unincorporated, or a trust if (a) there are three or more individual trustees; or (b) the trustee is itself a juristic person, but does not include a stokvel’ (Government Gazette No. 28619, 2006: p22).

³⁴ Section 7(1), the Minister in charge of consumer credit sets this threshold from time to time, at present it is R1m and may not apply where assets or turnover are less than R1m, but the transaction entered into is greater than R250,000.

³⁵ Under the NCA, an incidental credit agreement is one where goods or services are provided to the consumer and interest becomes payable only when payment is not honoured on or before a predetermined date.

provided for under the NCA include *developmental* credit agreements³⁶ (including educational loans, loans between credit cooperatives or credit for low-income housing) and *public interest* credit transactions³⁷ (as may be extended during times of grave public distress like in case of natural disasters). Such agreements may come into operation upon a ministerial declaration by a notice in the Government Gazette.³⁸

The Act includes the Consumer Credit Policy relating to consumer rights (§60-66),³⁹ credit records and confidentiality (introducing a national register of outstanding credit agreements (§69) and credit marketing practices (in which potentially misleading advertisement and sale of credit at homes or workplaces are prohibited). This part of the NCA also introduces the over-indebtedness and reckless credit provision which deals with lender liability for irresponsible lending, defines over-indebtedness, and prescribes relief measures thereof. Under this clause, a consumer is judged to be over-indebted if the available information during determination indicates that he/she is not, or will not be able to satisfy in a timely manner all the agreements to which he/she is a party (§79(1)). As such, an agreement is deemed to be reckless if the consumer's ability to pay was not duly assessed by the credit provider or where the assessment was made, but the consumer did not understand the dynamics involved or where the lender neglected the negative results of the assessment (§80).⁴⁰

In terms of the Act normal contractual disputes are settled by courts. In the event that prohibited conducts have been established, a judge of the High Court, a regional magistrate

³⁶ Section 10 (1) & (2).

³⁷ Section 11 (1) to (5).

³⁸ Section 10 (2) and Section 11(1) & (2).

³⁹ The right to apply for credit, protection against discrimination, right for reasons why credit is denied, right to information in official languages, right to documentation.

⁴⁰ This section calls for close cooperation between the consumer and credit provider in that the Act requires credit providers to conduct a thorough assessment before entering into an agreement whilst the consumer must disclose information fully and truthfully. If the agreement is deemed reckless, in this case, the court may make an order; Section 83(2)a; suspending consumer rights, or Section 83(2) b; suspending the agreement. A potentially contentious issue appears in Section 81(4); '...it is a complete defense to an allegation that a credit provider ...establishes that the consumer failed to fully and truthfully answer any requests for information made by the credit provider.... This is because, regardless of all the available assessment mechanisms (section 82), it becomes very hard to judge whether the credit provider indeed *established* or was able to *establish* that the consumer concealed some of the truth. Even if he does, he will not be prepared to admit that he did as this would compromise his case.

or a magistrate may issue an ‘enter and search’ warrant (§153) subject to certain powers and specific conducts contemplated in sections 154 and 155. In case of an ‘offence’,⁴¹ the culprit will be liable for a fine or imprisonment (for a period not exceeding 10 years), or to both (§161).

2.3 Establishing the need for the NCA

The NCA and its regulations were introduced with strong welfare and micro-economic objectives. Prior to NCA, the credit market was regulated by a number of different laws, primarily the Usury Act and the Credit Agreements Act 74 of 1980. The Usury Act added an exemption in 1992 allowing money lenders to loan out amounts not exceeding R 6,000 (for a period not exceeding 36 months) without an interest rate ceiling. The lure of unregulated interest rates precipitated a rapid growth of the micro-lending industry. This rapid growth and the wide-ranging abuses that ensued due to the absence of proper regulation forced government to introduce a second exemption (1999 Exemption Notice) under which the maximum amount allowed for money lenders was increased to R 10,000 but with a cap on the interest rate. In addition, the government also established the Micro Finance Regulatory Council (MFRC) to regulate the micro-lending industry and new regulations to govern the industry were added (Kirsten, 2006; Schoombee, 2004; Porteous, 2003; Meagher, 2002).

Kelly-Louw (2008) notes that these laws were inconsistent in enforcement and interpretation, provided only selective disclosure of credit terms and treated different credit providers differently which undermined consumer protection. This necessitated a comprehensive legislation with strong tools to influence market responsibility through a mechanism that would inter alia, enforce disclosure and information sharing and eradicate reckless market behaviours in order to protect consumers from over-indebtedness and related problems. The process of formulation of the Act drew on several reports and commentaries dating as far back as 1992, and a number of policy documents of the ANC government (dti, 2004b). These

⁴¹ The Act defines various ‘offences’ and indicates whether these should be dealt with by the Magistrates’ Court or the High Court. These include breach of confidence (section 156), obstruction of the administration of the Act (section 157), failure to attend hearings when summoned (section 158), failure to answer fully or truthfully (section 159, subject to section 139(5)) and failing to comply with an order of the tribunal (section 160).

reports agreed broadly that the laws in place at the time were weak and outdated in the sense that they were no longer appropriate for a modernising and growing credit environment and, therefore, a complete review of the entire credit policy and legislation was deemed necessary (dti, 2003).⁴²

Such reports included the 1992 South African Law Reform Commission's (SALRC) review of the Usury Act which highlighted far-reaching consumer abuses, including abusive debt collection procedures, extortionate interest on payroll-deductions and legal practitioners' abuse of administrative orders. The SALRC report also argued that the fragmentation of the credit legislation was a major weakness and particularly noted the application overlap between the Usury Act and Credit Agreements Act. In another report by the National Small Business Regulatory Review Board (appointed in December 1997 by the Minister of Trade and Industry to investigate the appropriateness of the regulatory framework), serious gaps within the credit laws of the time were noted. Notably, gaps in the flow of information which made it difficult to determine risk and resulted in the high cost of lending especially from non-bank institutions, inappropriate credit criteria and discriminatory lending practices which stifled access to finance by the small business sector (Ntsika, 1999:35). The two reports thus recommended a repeal of both the Usury and Credit Agreement Acts and the enactment of comprehensive consumer legislation.

Further disapprovals of the dysfunctional credit legislation also prompted the Policy Board for Financial Services and Regulation⁴³ in 2001 to appoint the Hans Falkena Task Group with a mandate to review experiences and trends in local and international regulations in order to make proposals for a new regulatory framework for SME financing. In their report the Task Group highlighted the problem of very limited access to finance for start-ups, micro-

⁴² The DTI argued that the inadequacy of the legislative framework was demonstrated by the fact that an industry as big as the micro-lending industry, and one which dealt with some of the most vulnerable consumers, was dealt with under an 'Exemption Notice' (dti, 2003:11) – the Exemption Notice being secondary legislation passed in terms of the Usury Act.

⁴³ The Policy Board for Financial Services and Regulation (No. 141 of 1993) was created by an Act of Parliament in 1993 to 'provide for the establishment of a board to advise the Minister of Finance on policy matters with regard to financial services and financial regulation; and to provide for matters connected therewith' (Government Gazette, No. 15168, 13 October 1993).

enterprises and entrepreneurs from previously disadvantaged communities or any other group with limited collateral. The Task Group also found that given the right regulatory environment, non-bank financial intermediaries had a potential to play a much larger role in enterprise lending than was the case (Falkena Committee, 2001:4).

Other findings of the Falkena Task Group included deficiencies in access to information necessary for risk assessment and evaluation of cost and availability of finance; barriers to entry and expansion of financial institutions and limitations on access to the national payments system by smaller banks and non-bank institutions, thereby nurturing monopolistic tendencies in the sector. They concluded that, in principle, all these factors were creating disincentives for the provision of certain types of finance (including SME finance) and innovation in the financial sector, as well as limiting the growth potential of certain types of financial service. The Task Group also recommended that the Usury Act and Credit Agreements Act be replaced with a consolidated national consumer credit legislation which should apply to all credit providers, with 'truth-in-lending' provisions, improved regulation of credit bureaux and the establishment of a national register of pledges.

In response to the above-mentioned reports and recommendations by others interested parties, Dr. Alistair Ruiters (the then Director-General of the DTI), mandated a Technical Committee (the Committee)⁴⁴ in March 2002, to conduct a comprehensive review of the consumer credit policy and legislation in order to present proposals for a policy framework for the regulation of consumer credit (dti, 2003:9). According to Goodwin-Groen and Kelly-Louw (2006:13), since the DTI's mandate is limited to overseeing the credit market, other financial services or savings were not part of this Committee's brief.

The Committee conducted extensive research. It sought opinions from a number of experts and requested for research into different aspects of the consumer credit market while focusing mainly on consumer perceptions about credit products. It held focus groups to consider credit providers' views and consumer protection possibilities. It canvassed the views of industry

⁴⁴The members of this Technical Committee were Professor Roshana Kelbrick, Mr. Moses Moeletsi, Dr. David Porteous, Mr. Kgosi Pule and Mr. Gabriel Davel, all of whom either worked for or were consultants for the MFRC.

and credit market stakeholders on the regulatory framework and conducted a statistical and economic analysis of the consumer credit market, in terms of value and cost differentiation (dti, 2003:11). The Committee also commissioned a number of expert opinion papers (Dymski, 2003; Herbstein, Gihwala, Willemse & Mxunyelwa, 2002; Meagher, 2003) and research reports (Hawkins, 2003; Reality Research Africa, 2002 and Rudo Research, 2002).

From meetings and discussions with government officials, industry representatives and academics in June 2003, an American professor – Gary A. Dymski⁴⁵ – produced a paper on the level of interest rates and the impact of the usury caps in the credit market. He argued that the Usury Act Exemption Notices created a dual market where the rich borrowers had the luxury of favourable rates while the poor had to borrow at exorbitant unregulated rates (Dymski, 2003:15). He opined that lifting or removing interest caps would lead to market expansion and cheaper credit for everyone.

Herbstein et al. (2002)⁴⁶ presented opinions from a *practical perspective* using their *experience in legal practice* (ibid.: 1). Their opinions include prohibiting unsolicited lending and eradicating the rampant abuses in the debt collection mechanism. They also called for paternalistic interventions to avoid over-indebtedness by introducing caps on debt as a percentage of income and prohibition of payroll deductions (ibid.: 6). Other recommendations included formulating a dedicated credit regulator to provide consumer redress as this could not be achieved through courts due to cost and efficiency implications. They also called for the removal of interest rate caps, arguing that these perpetuated the financial exclusion of a vast majority of low-income households.

Patrick Meagher⁴⁷ reflected on the Pay-Day Loans (PDL)⁴⁸ situation in the United States which he equated to the micro-loans in South Africa. He argued that although such loans

⁴⁵ Professor, Department of Economics (University of California, Riverside).

⁴⁶ Hofmeyr, Herbstein & Gihwala Inc.

⁴⁷ IRIS Center, University of Maryland.

⁴⁸ Meagher defines PDL as those where workers apply for a short-term cash loan at a PDL outlet; the lender verifies their details. If approved, the loan is extended against a post-dated cheque for the principal and interest – or the interest and any other fees. The loan term is usually two weeks, and the loan is repaid on payday. Failure to repay, the options include a rollover for a fee, refinancing (new loan with new fees), or the lender will present the check (ibid.: 2).

offer rapid and convenient service in underserved communities, the terms were costly and the lenders were notorious for consumer rights abuses yet many consumers of such loans would qualify for mainstream credit under better conditions (Meagher, 2003:3). He also proposed regulatory reform initiatives that would see lender associations volunteering to address major concerns and state legislations to outlaw some products or allowing them to operate under specific conditions.

Other reports that informed the credit law review include Reality Research Africa (2002), Rudo Research (2002), and one by Penelope Hawkins of the economic consultancy Feasibility Ltd (2003). Hawkins (2003) analysed the cost, volume and allocation of credit in South Africa using administrative data from the South African Reserve Bank and the MFRC as well as other data from ‘various industry associations’ and industry experts (ibid.: 6). She found that the cost of credit was exceedingly high in some market segments while the demand far exceeded supply in others owing to inter alia weak disclosure, poor information access and sharing, and regulatory uncertainty which encouraged high pricing. She attributed these factors to distortions created by the disparate and fragmented consumer credit legislation (ibid.: 11). The report recommended the removal of interest rate caps which had proved quite burdensome to the poor. Other recommendations were the provision of an equitable access to the payment system, a better mechanism for information sharing, and ensuring consistent enforcement of legislation.

Reality Research Africa (2002) explored perceptions of South African consumers with regards to credit contracts disclosure and consumer rights through focus groups. This investigation found that very few consumers were aware that they had any rights under credit transactions; most consumers did not read or understand their contracts; widespread selective disclosure by lenders and most of the credit extended carried hidden costs. Unsolicited credit extension and unsolicited payroll deductions were found to be rampant, affecting mostly those with secure employment or those who regularly serviced their accounts, especially civil servants. It also found a general lack of awareness of the interest rates dynamics, the cost of the credit, or the availability of channels of consumer redress.

Rudo Research (2002) employed a combination of focus groups and face-to-face interviews with a number of credit market stakeholders to analyse perceived weaknesses of the credit legislation. It concluded that a lack of an enforcement mechanism for the Usury Act had led to non-compliance on such important requirements as disclosure, citing micro-lenders as the least compliant (ibid.: 46). In addition, the low ceiling (R10 000) imposed by the 1999 Usury Act Exemption Notice was blamed for creating barriers to differentiation and that this led to extortionate rates for amounts below the ceiling. The report found that the regulatory fragmentation (between three different Acts) was compromising consumer protection, whilst the regulatory overlap which allowed different Acts to have their own protection requirements was confusing and detrimental to consumer protection. The research recommended (among other things) the formulation of a consolidated credit Act addressing all aspects of the credit market with a dedicated central loan registry.

In February 2004 the Committee submitted its report to the DTI. This was based on the conclusions of the above reports and the earlier reviews. In the report, the Committee had concluded that existing legislation had become obsolete, ineffectual and anomalous and was compromising consumer protection and competition in the credit market, yet the credit market had evolved significantly over the years.⁴⁹ Legislation was also distorting the market through its differential and unequal treatment of different credit products and credit providers (dti, 2004a:12-13). The Committee concluded, further, that the market was beset by severe segmentation, with two credit markets in the same economy (one that serviced the low-income and SMEs and the other serving the middle and high income – ‘predominantly white’ – and large enterprises) whilst the majority of the population lacked access to reasonably priced credit.⁵⁰ Specifically, consumer protection was being compromised by the rising

⁴⁹ Also see Vessio (2008:227) citing J.M. Otto (2006) *Credit law commentary*; “The Usury Act and Credit Agreements Act ‘have together regulated consumer credit in South Africa for more than a quarter of a century, [but now the] legislature has considered it wise to replace them with one piece of legislation’”.

⁵⁰ The situation was also characterised by an over-supply of credit to those considered creditworthy. This resulted in a large number of consumers facing heavy debt burdens, whilst, some consumers were so heavily indebted that their day-to-day lives were negatively impacted upon (ibid: 13).

levels of over-indebtedness; reckless credit granting and exploitation of consumers by micro-lenders, intermediaries, debt collectors and debt administrators.

In its proposals, the Committee suggested a complete overhaul of the whole credit systems. The Usury Act, the Credit Agreements Act, certain provisions of the Magistrates Courts Act and the common law had to be replaced with a consolidated and simple credit Act that would address all the underlying structural problems (dti, 2004a). They anticipated a credit Act that would be able to correct the deficiencies of the old legislation, especially by ensuring exhaustive disclosure and information sharing, the prevention of reckless lending and consumer over-indebtedness, the creation of a dedicated central regulator and improved channels of consumer redress and debt rehabilitation. In August 2004 the DTI adopted the proposals of the Committee and drafted the ‘a policy framework for consumer credit’ document which ‘provided policy direction’ on the regulation of the consumer credit market (dti, 2004b: 38), the contents of which were central in drafting the National Credit Bill.

According to the DTI the policy direction was discussed widely within national and provincial government. Within national government the DTI consulted with a number of departments whose mandates related to the field of consumer credit, including the Department of Justice;⁵¹ the National Treasury (because they were the monitoring institution for household debt and savings as well as overseeing bank supervision) and the Departments of Housing and Education. Further discussions were held at provincial government level through joint-working groups as well as multilateral and bilateral discussions with business and labour organisations represented in the corporatist National Economic, Development and Labour Council (Nedlac), with the general public and with Parliament (dti: 2004a). Contrary to the DTI’s claims, minutes of such discussions could not be found in the public records. According to the DTI, the feedbacks that were received on the policy document were

⁵¹Because the Justice Department had jurisdiction over the Magistrates’ Courts Act, and the Insolvency Act, both acts required amendment in order to implement the proposals of the consumer credit policy (ibid: 37). The Usury Act, Credit Agreements Act and debt collection procedures were all enabled by the Magistrates’ Courts Act 32 of 1944 (See Godwin-Groen, 2006:13). The Insolvency Act 24 of 1936 being the principal Act dealing with insolvency in South Africa was amended in February 2000 (see The South African Law Review Commission ‘s *Review of the law of insolvency*).

integrated into the draft legislation (the National Credit Bill). The DTI also hosted a two-day workshop (19 – 20 October, 2004) to which Black Sash (a consumer rights-based NGO), among others, was invited – to present opinions on the draft Credit Bill. The DTI described this workshop as an internal procedure to inform the Bill before it got to Parliament.

2.4 Legislative history of the NCA

The National Credit Bill [18-2005] (hereafter the Bill) was presented to Parliament on the 8 June 2005. Upon presentation, a notice for formal comment from interest groups was published on 11 July 2005. A number of industry protagonists, civil society organisations and consumers made submissions to the Portfolio Committee on Trade and Industry (hereafter the Portfolio Committee) during the five sessions of hearings between 5 and 19 August, 2005. This was followed by four sessions of deliberation in the Portfolio Committee between 7 and 16 September. The submissions by some key stakeholders on the draft law during the committee hearings are described in this section, followed by the issues raised and debated by the legislators during the four sessions of deliberation.

2.4.1 Presentations to the Portfolio Committee

Since the DTI oversees consumer protection policies through its Consumer and Corporate Regulation Division, the credit market is within its mandate and, therefore, the DTI presided over the consideration of the draft Bill in the Portfolio Committee. Representatives from the DTI explained issues that required clarity from the public and the Committee, defended clauses that were found to be contentious and made amendments as deemed necessary. Credit providers and consumer-interests groups including trade unions and non-profit organisations (NPOs) made submissions to the Portfolio Committee on the draft bill and on other issues impacting on the consumer credit system. What emerged from the respective presentations was that credit providers were largely comfortable with the existing legislation, and less inclined towards the proposed law as they found it to be too intrusive, limiting and biased towards consumers. The key sticking points raised by this group included the lack of attention given to secured lending; the extreme compliancy requirements and the cumbersome debt recovery procedures. Contrarily, consumer-interests groups were very critical of the existing legislation and lending practices, but very optimistic about the draft bill as they contemplated

it to be capable of solving existing problems. For this group, their notable opposition lay with the provisions on emergency loans, but they also asked demanded direct relief from debt distress and the erasure of consumers' adverse records – drawing stiff opposition from the lender-interests groups.

2.4.1.1 Retail credit providers

Among the retail credit providers who made submissions on the credit Bill, were the Furniture Traders Association (FTA) who represented furniture retailers under their umbrella; the Clothing Retailer Members of the Consumer Credit Association who represented the clothing retail industry, while Truworths (a clothing retail chain store) made independent submissions to the policy Committee. The retail credit providers commended the information sharing and creditor registration provisions of the draft legislation as having a potential to reduce the costs of risk assessment and root out unscrupulous lenders respectively.

This group generally accepted that a number of problems existed in the credit market and conceded that some credit providers could be directly culpable. They noted a growing problem of consumer over-indebtedness which they blamed on reckless credit granting by 'some' unscrupulous credit providers which, they argued, affected lenders as well as consumers. They also noted that this problem was exacerbated by the lack of seriousness in enforcing registration of credit providers, while the information sharing and registration infrastructure was very poor in some areas and non-existent in others.

As credit providers in general had earlier been widely maligned for practicing credit discrimination, these credit providers countered that the absence of a sound consumer information sharing infrastructure was responsible for credit discrimination, as credit risk assessment was being rendered almost impossible. They also noted that, even in the presence of credit discrimination, poor information sharing was increasing incidences of over-indebtedness and this was impacting on business.

The retail credit providers also expressed a number of reservations regarding the draft law, notably the insurance provisions; the debt recovery procedures; the complexity and extreme

compliance requirements of the proposed legislation, as well as the provisions relating to expunging of consumer records.

The Clothing Retailers' Association considered the provision on credit insurance to be impractical and warned that this would be disadvantageous to consumers.⁵² They had reservations about the proposed concept of debt counselling and cautioned that there was a huge potential for abuse. They submitted that the moratorium on interest during the period of debt counselling would impact negatively on cash flow and balance sheet. Further dissatisfaction related to the 'disproportionately' severe penalties contemplated in section 161,⁵³ arguing that the complexity and scale of the draft law, among others, would make it almost impossible to comply fully with its requirements and feared that the new law would have cost, process, technology and timeline implications for business. They opined that the 'extreme' compliance requirements would stifle start-ups and low-capital businesses and the productivity of those already established.

The credit assessment requirements of the draft legislation were found to be too stringent by the retail credit providers indicating that it would lead to tighter credit constraints which would counteract the policy objective of improving credit accessibility. They noted, further, that such requirements would draw consumers towards loan-sharks (Truworths). The provision for expunging of consumers' credit bureau records after debt adjustment or judgment (§71) was another issue of concern for the retail credit providers. They argued that this would mean that lenders would not be able to satisfy conditions set in respect of assessment of debtors' repayment capacity (§ 81(2)a(ii))⁵⁴ and, consequently, further

⁵² The FTA considered the new credit life insurance not to be in the interest of the consumer on three fronts. For example, in the existing situation, premiums were paid up-front. The new legislation, however, required monthly payment of premiums. One or two policies covered all-risk, but the new provision required up to four policies covering equal risk. Further, while the old policy allowed for cover of replacement value of goods for the duration of the contract, in the new policy; cover is based on the current outstanding balance only, i.e., once this falls below the value of the goods, the goods cannot be replaced and this is to the disadvantage of the consumer.

⁵³ Section 161: Any person convicted of an offence in terms of this Act, is liable—

(a) in the case of a contravention of section 160(1), to a fine or to imprisonment for a period not exceeding 10 years, or to both a fine and imprisonment; or

(b) in any other case, to a fine or to imprisonment for a period not exceeding 12 months, or to both a fine and imprisonment. (Note that this section was not amended).

⁵⁴ Section 81(2) (a) (ii); A credit provider must not enter into a credit agreement without first taking reasonable steps to assess- (a) the proposed consumer's- (ii) debt re-payment history as a consumer under credit agreements;

restrictions on credit access.⁵⁵ Regarding credit limits (§ 119), they proposed that these continue to be periodically altered at the discretion of credit providers subject to the consumer's risk profile, motivating further that this was 'global best practice' (Clothing Retailers' Association).

In conclusion, the retail credit providers submitted that, although consumer protection was important for the industry, it had to go hand in hand with the protection of the credit industry especially since retail business was considered a high risk segment and therefore more susceptible to investor jitters yet an important employer.

2.4.1.2 The micro-loan providers

The micro-loan providers were represented by their umbrella organisation, the South African Money Lending Affairs Council (SAMLAC) and one small loans provider (Bilbao Finance Proprietary). The moneylenders did not comment on the problems affecting consumers, which was rather predictable given that this group was widely blamed for many of the consumers' debt problems. In fact, some consumer interests groups suggested that many of the micro-lenders were indistinguishable from the notorious loans-shark (mashonisas) given their modus operandi including confiscation of ATM cards or ID books. For their part, the micro lenders cited two symptoms of the regulatory weakness: the absence of an organised central loan registry and the arbitrary debt counselling and administration procedures. Like the retail credit providers, the micro-lenders submitted that the absence of an organized registry made risk assessment almost impossible. They also submitted that debt counselling, consolidation and administration, were being conducted arbitrarily with many dodgy individuals approaching them for such services. They thus proposed the introduction of a more organised registry, with strong checks and balances to ensure that the updated credit information is submitted promptly (Bilboa Finance) and also called for strong regulations on debt counselling and administrative services.

⁵⁵ The retail credit providers then recommended that the then retention period of the credit bureaux information be maintained even where judgment has been secured, i.e., a minimum retention period of at least 24 months for qualitative adverse information.

As to the draft legislation, micro-lenders submitted that provisions on the registration requirements, administrative fines, debt enforcement and the selling of credit at homes as well as the ministerial authority on interest rates were overly paternalistic, intrusive and potentially harmful to their trade.

Regarding the registration provision (§ 40 (1) a), they thought that it was unfair that all moneylenders had to register regardless of the size of their loan books or the size of the credit. For example they suggested that Pay Day Loans (PDL) should not only be differentiated from other loans, but should also be exempted from those statutory requirements that would make it impossible to survive. They argued that PDL lenders provided a much needed service as in many instances PDLs were the only source of funds available for a large disadvantaged section of the population. Attempting to motivate this argument further, the micro-lenders cited (without explaining) research conducted for the DTI by Ebony Consulting (SAMLAC).⁵⁶ The contradiction, however, is that this research presents a damning indictment of micro-lenders' exploitative practices, noting among others, the over-lending and arbitrary costs (with interest rates varying between 60 per cent for long term loans and even surpassing 1000 per cent for very short loans (of less than a week) and a complete lack of rates disclosure.⁵⁷

The micro-loan providers also queried the administrative fines as provided for in the draft legislation. They submitted that penalties and fines were not in line with the offences according to other legislations (§ 151(i-iii)), and argued that 10 per cent of turnover or a R1 million fine would definitely lead to the closure of any micro-loan provider (SAMLAC).

The micro-lenders also expressed their concerns with what they considered lax debt enforcement provisions of the draft legislation and cautioned that this would increase default rates. Like the retail credit providers, SAMLAC argued that the moratorium on interest and

⁵⁶ Government Gazette (No. 21381, 2000) DTI, Report on cost and interest rates in the small loans sector: Ebony Consulting International (Pty) LTD.

<http://www.info.gov.za/view/DownloadFileAction?id=66262> (Accessed 20 November 2008).

⁵⁷ The study also found that moneylenders were exploiting the fact that borrowers in this market segment were myopic with regards to the cost of credit. It notes further that micro-lenders knew that consumers were less concerned about the interest rates and more concerned about getting the money and so lenders were maintaining an almost complete lack of rates disclosure.

costs and enforcement of creditor rights during debt counselling are overly debtor-friendly and seem to give consumers licence to abandon their obligations whenever they wish to, and will thus mortally hurt the lending trade.

Regarding the clause prohibiting the selling of credit to clients in their homes, micro-lenders found this to mean a loss of employment to the many credit agents they employed around the country, and motivated that selling credit at homes was in line with international trends and provided consumer convenience. The micro-lenders were also uncomfortable with the fact that the minister was given unwavering authority to cap interest rates, especially if these were to be decided retroactively, as it would create a lot of uncertainties.

2.4.1.3 Motor vehicle dealers

Motor vehicle dealers were represented by Imperial Holdings, a member of the National Automobile Dealers Association (NADA).⁵⁸ Intuitively, Imperial Holdings' concerns stemmed from section 121 of the bill regarding rescission and termination of credit agreements⁵⁹ and the applicability of this section to non-returnable goods. They noted that the wording of section 121(5) applies to depreciation of the goods only when in a consumer's possession yet in the case of motor vehicles, the decrease in value occurs upon registration and that circumstances might arise where a customer signs a credit agreement, the vehicle is registered in his/her name, and then he/she rescinds the agreement before even taking possession of the vehicle. They indicated that the high depreciation rate would prejudice vehicle consumers trying to rescind credit agreements; and that considerable amount of time

⁵⁸Imperial Holdings is involved in motor vehicle retail through its Motor Division and also the financing of motor vehicles sold to the public through the Motor Finance Corporation division of Imperial Bank.

⁵⁹Section 121 (2): a consumer may terminate a credit agreement within five business days after the date on which the agreement was signed by the consumer, by-

(a) Delivering a notice in the prescribed manner to the credit provider; and

(b) Tendering the return of any money or goods, or paying in full for any services, received by the consumer in respect of the agreement.

4) A credit provider to whom property has been returned in terms of this section, and who has unsuccessfully attempted to resolve any dispute over depreciation of that property directly with the consumer and through alternative dispute resolution under Part A of Chapter 7, may apply to a court for an order in terms of subsection (5).

(5) If, on an application in terms of subsection (4), a court concludes that the actual fair market value of the goods depreciated during the time that they were in the consumer's possession, a court may order the consumer to pay to the credit provider a further amount not greater than the difference between- (a) the depreciation in actual fair market value, as determined by the court; and (b) the amount that the credit provider is entitled to charge the consumer in terms of subsection (3)(b).

and resources would be brought to bear on a retailer obliged to accept a returned vehicle. They highlighted the difficulty of recovering the cost of depreciation from a consumer who is not able or willing to pay and warned that the tribunal would be overwhelmed by the number of cases referred for consideration in this regard.

Citing their industrial experience, Imperial Holdings submitted that the moment a new motor vehicle is delivered to a customer, its realisable value immediately falls by at least 10 per cent. Even before delivery, part of its value is permanently lost as it will already be classified as previously owned (a previous owner is indicated on registration system) regardless of mileage or condition. They reflected on past experiences where customers had ample opportunities to consider purchases and even test drive the vehicles, but still regularly attempted to return vehicles just acquired for a variety of reasons, including simply not liking the vehicle or other practical considerations. They thus proposed that motor vehicles be exempted from the provisions of section 121 or be classified non-returnable altogether.

2.4.1.4 COSATU

The country's leading labour union federation and an influential member of the ruling party's Tripartite Alliance, the Congress of South African Trade Unions (COSATU) had an important stake in this policy formula, mainly as the legitimate representative of South Africa works – or so it appears. COSATU was of the view that tougher regulations, capping the interest rate and some form of amnesty were needed both as a way of protecting the workers from unscrupulous lenders and as redress for the many years of abuse and 'crippling exploitation' of workers (August 31, 2005). This they blamed on the inadequacies of the legislations of the time (particularly the Usury Act). COSATU openly suggested that credit access was a right and that financial institutions had a duty not only to make credit easily and cheaply available but also to cater adequately for low-income housing and micro enterprises. They accused banks of 'systematic red-lining of targeted communities',⁶⁰ and the credit

⁶⁰They referred the Committee to a presentation by labour representatives to the Finance Portfolio Committee on the Financial Sector Charter by Bheki Ntshalintshali: COSATU Deputy General Secretary – 17 September 2004.

bureaux of being intransigent, unwilling to transform and of unfair discrimination by selling credit information for profit.

They expressed their satisfaction with the draft legislation in spite of a few technical issues. Above all, COSATU wanted the bill to achieve two things: afford access to credit for low-income families and amnesty for those ‘unfairly’ blacklisted or those facing unmanageable debt – as the primary objective, and catering for the business interests of credit providers should be as the secondary objective, and they insisted that this order of priority was very important.⁶¹

They had some minor reservations on the draft legislation too. Notably, they were concerned about the provision on debt counsellors as they found this provision to be loosely defined in terms of the minimum qualifications and eligibility for registration and thought it would provide incentives for fraudulent characters to masquerade as debt councillors. COSATU also objected to the provision of ‘emergency loans’, submitting that its definition explains the very conditions under which the poor take up loans.⁶² They argued that credit providers would exploit this loophole by extending reckless loans to the poor dressed up as ‘emergency loans’.⁶³ COSATU indicated that its arguments were informed by empirical literature from the Financial Diaries project of the CSSR and SALDRU (University of Cape Town),⁶⁴ and a seminal study by Hawkins (2003).⁶⁵

⁶¹ ‘Thus the National Credit Bill has the potential to achieve: first and foremost, the long-standing demands of consumers of credit, particularly those of low-income earners; persons who were unfairly “blacklisted” by credit grantors; and relief to households negatively affected by their practices, and as a secondary objective, to balance the business interest of credit grantors, within the framework of an equitable, sustainable legislative regime. ... This order of prioritisation is critical we maintain...’ (COSATU submission on the National Credit Bill [B18-2005] (31 August 2005).

⁶² An ‘emergency loan’ being a credit agreement entered into by a consumer to finance costs arising from or associated with-

(a) a death, illness or medical condition;

(b) unexpected loss of income; or

(c) Catastrophic loss of or damage to home or property due to fire, theft, or natural disaster.

⁶³ Section 78 (2)b ; A loan is not considered reckless if entered into for purposes as those provided in the definition of an emergency loan (see footnote above) so a credit provider cannot be prosecuted for reckless credit granting if the loans in question was an emergency loan.

⁶⁴ <http://www.financialdiaries.com/index.htm/> [2009 November, 13].

⁶⁵ This was one of the research reports (reviewed in the earlier section) that informed the credit law review Technical Committee set up by the DTI in 2002 (see section 1.1).

2.4.1.5 Non-profit Organisations

The Black Sash (a human rights-based NGO involved in financial literacy, advocacy and paralegal issues); the Financial Sector Campaign Coalition (FSCC) (a network of member civil society organisations) and the Savings and Credit Co-operatives League (SACCOL) presented arguments to the policy committee. These NPOs presented a collective view that previous credit laws were ineffective in dealing with a credit market growing in size and complexity; and that these were inconsistent and fragmented thereby making consumers extremely vulnerable to abuse by unscrupulous credit providers.

The NPOs jointly endorsed the bill's provisions on reckless lending practices; limits to total costs of credit and interest rates; access to credit information; simple language contracting with full disclosure of credit terms and conditions as well as regulation of credit information and credit bureaux. However, they also had common concerns with the provisions of debt counsellors; emergency loans; credit assessment mechanisms and the cost of sustaining the proposed legislation. In addition, they wanted the legislators to consider issues related to credit bureau information and blacklisted consumers.

Like COSATU, the NPOs expressed their reservations on the provision of debt counselling. They requested for an amendment that would make debt counselling a free service provided by the state or NGO paralegals and motivated that many consumers will not be in a position to afford paying for the service given they will be in dire financial straits. They warned that paying for debt counselling would lead to the exclusion of those who need it most.

On the exemption of 'emergency loans', 'school loans' and 'public interest loans' from reckless lending judgment, the Black Sash warned that such exemptions might result in greater hardship to borrowers who are already victims of negative 'unanticipated life events' and might countervail the compassionate intentions of the legislature. The FSCC even described the exemption as '...dangerous in its naivety and at worst both cynical and heartless' and thus had to be removed.

The NPOs also argued that the clause which gives credit providers the power to choose their own assessment mechanisms and procedures⁶⁶ was in direct contradiction with the bill's pronouncements on introducing national norms and standards and consistent enforcement framework.

Like COSATU, the NPOs recommended that the regulator ensure that credit bureau information only be supplied for assessment of the individuals' creditworthiness as opposed to the then prevailing practice of selling the information to employers for employee screening. They also recommended an amendment to provide for amnesty to all South Africans who were blacklisted by credit bureaux. In motivating the issue, the FSCC submitted that at least two million South African adults were blacklisted and this was affecting as many as 10 million others who depended on them. SACCOL demanded amendments to cater for the unique structure of the Savings and Credit Co-operatives (SACCO) in South Africa, as well as recognise and cater for the co-operative tiered structure of primary, secondary or apex cooperatives.

In an in-depth interview 3 years after the introduction of the NCA, Black Sash indicated that they were able to garner some satisfaction from their contributions which resulted in the incorporation of the pre-agreement disclosure requirements (NCA §92) and section 128 regarding, referral of a consumer to a debt counsellor or consumer court.⁶⁷ Black Sash also indicated that some of their ideas directly contributed to the section on debt procedures in a court,⁶⁸ particularly the debt review. They claimed to have piloted the practice before the introduction of the Act as a debt relief programme in their Knysna office. The Sash, however, still found the application of the debt counsellor provision problematic, noting that many of those who are registered as debt counsellors under the NCA were formally debt

⁶⁶ Section 82(1); Subject to subsections (2)(a) and (3), a credit provider may determine for itself the evaluative mechanisms or models and procedures to be used in meeting its assessment obligations under section 81, provided that any such mechanism, model or procedure results in a fair and objective assessment.

⁶⁷ 'If the consumer is in default under a credit agreement, the credit provider- (a) may draw the default to the notice of the consumer in writing and propose that the consumer refer the credit agreement to a debt counselor, alternative dispute resolution agent, consumer court or ombud with jurisdiction....

⁶⁸ Section 130 (4)c.

administrators, collectors and consolidators who are in it purely for the money, while many of them have a history of consumer abuses.

2.4.1.6 The banks

First National Bank (FNB) and Standard Bank Limited made a joint submission with the Banking Association and independent submissions to the policy Committee during the hearings and intuitively, their main interest was in asset-based finance. While FNB was mainly interested in vehicle finance, Standard Bank's main interest was housing finance. Just like other lender-interests groups, the banks submissions seemed to suggest that they were to a larger extent comfortable with credit legislation as it was at the time, and less comfortable with many aspects in the proposed legislation.

The banks argued that the proposed law had completely neglected asset-based finance which according to them was aptly provided for in both the Credit Agreements Act and the Usury Act. They cited the definitional problems of the 'lease' and 'installment agreement' as the main areas of contention, specifically, referring to Sections (121, 127, 129 and 92). They highlighted their displeasure with provisions relating to the surrender of goods⁶⁹ which they considered to be slow and unwieldy and that the entire burden would be shouldered by the credit provider (FNB). They thus suggested amendments so that consumers are required to bear such costs, since they (consumers) are often at fault in such situations.

The banks also found the draft provisions on debt enforcement in the context of asset-based finance to be cumbersome and feared that it would be a lengthy, drawn-out and an expensive procedure.⁷⁰ Regarding the requirement for a five-day cooling-off period for a customer to make up his mind after the quotation, the banks considered this to be redundant and impractical⁷¹ especially since bank rates would not be expected to hold constant within that time, whilst the consumers' economic situations might change or they may change their minds while the credit provider is kept waiting. They therefore suggested that quotations be

⁶⁹ Section 127.

⁷⁰ Section 129(b)(1) as contemplated in Section 86(9) as contemplated in Section 86(7)(c).

⁷¹ Referring to Section 92(3)(b)(iii).

given only at a consumer's request without any obligation on the part of a credit provider to hold the goods during that period.

Standard Bank was unhappy with Section 103(1) as it expressly ruled out the practice of tiering interest rates, yet the bank considered this to be accepted practice and that phasing it out would disadvantage consumers.⁷² Section 106 (6) relating to credit insurance approaches was also found to be onerous and cumbersome and Standard Bank warned that this would lead to more costly insurance for consumers.

In an interview (three years after introduction of the NCA), FNB intimated that, without changes in policy, decreases in the sale of credit and increases in the numbers of consumers going under debt counselling due to over-indebtedness were very imminent and feared that this would enormously affect their trade and profitability. With the new legislation – in its current form – FNB anticipate an abuse of the debt counselling provisions much like in other bankruptcy laws. It thus hopes that future reforms would place at least a limit of 'say R100 000 on consumers that may apply for debt counselling' (FNB, August 27, 2009).

The banks motivated that all their views were influenced by market experience and took a practical position but were disappointed that the legislators acted more emotionally and less practically by not considering any of their recommendations. They cited a few problems that were resulting from the 'weaknesses in policy', notably, that 'the pricing change created a decrease in noninterest revenue with an increase in interest revenue' and the increasing volumes of people going under debt counselling with an enormous backlog in court (FNB, August 27, 2009).

2.4.1.7 The consumer

Consumers are rarely represented directly, but usually rely on intermediaries such as NPOs. In this case, however, one consumer, Ms Booley, gave life-story accounts of consumers who

⁷² 'This is problematic, as it has become accepted practice (linking the cost of credit to aspects such as reserving requirements and employment arrangements e.g. preferential rates for staff of defined entities which revert to prevailing customer rates upon termination of the employment contract). Should it not be possible to tier interest rates in line with the associated risk, credit providers will apply averages, which will prejudice customers and reduce access to credit' (Standard Bank submission to the Parliamentary portfolio committee).

had suffered due to having too much debt and being hounded by lenders and debt collectors. Her main concerns reflected the view of other consumer-interests presenters (i.e., the NPO and COSATU). Notably, she submitted that unregulated credit bureaux were applying arbitrary standards in their handling of information and black-listing of debtors while debt-collectors were acting like law unto themselves. She beseeched the Committee to consider a once-off amnesty for blacklisted consumers as well as a once-off forgiveness of their debt.

In summary, as mentioned earlier, the public presentations to the Portfolio Committee reflected the competing interests of business (lenders) and consumers. At times, the business-interests submissions attempted to sound as if they were equally concerned with the interests of consumers. However, the disputes on such issues as capping interest rates, expunging adverse records and emergency loans and the fact that they favoured the regulatory situation of the time compared to the proposed law, suggests that profitability and freedom of enterprise was their over-riding motivation. The business-interests groups were also steadfast in highlighting that selling credit was a business motivated by growth and sustainability, just like any other business and that credit customers had to earn the right of access. It is for this that issues of creditworthiness assessment capacity and debt enforcement were so important in their submissions.

Contrarily, consumer-interest groups depicted the credit industry including credit bureaux as direct oppressors who not only exploited the poor with expensively priced credit but also discriminated against a big portion of them. For these perceived transgressions, they hoped for increased access to credit as a right and argued that this should come through tighter regulations, limiting interest rates and total cost of credit, clearing adverse credit records and forgiveness of some debt in order to allow for a clean start. Most of these presentations can be seen as futile, as they did not result in any substantive amendments to the Bill, save for a few technicalities, – especially on the part of business-interests groups who were strongly opposed to a number of provisions. As for consumer-interests groups, their submissions can be seen as a vote of confidence for the DTI: their submissions were mainly revisions of the

problems in the market and legislation that had already been highlighted in the DTI's policy document, rather than opposition to the content or form of the draft bill.

Following the five sessions of public hearings, the politicians deliberated upon the issues raised in the four sessions that followed. The following subsection presents the major issues deliberated upon by the politicians.

2.4.2 The major issues discussed in the Portfolio Committee

On 7 September 2005 the Trade and Industry Portfolio Committee reconvened to deliberate upon the issues raised and further consideration of the draft Bill. The issues deliberated upon were mostly those that had not been well-received by the interested parties, since the politicians hardly raised any issues of their own, which seemed to suggest that they (politicians) did not have any objections to any provisions in the proposed law. The issues presented here are those that were more influential to the final enactment of the Bill within the context of its 'preventive' objectives. Emphasis is placed on issues related to consumer protection in general, and the avoidance of consumer over-indebtedness in particular, by encouraging responsible market behaviours and disclosure and information sharing, for much of the debate revolved mainly around arguments or clauses related to these issues.

Issues of substantive disagreement included, the complexity of the Bill; emergency loans; amnesty for blacklisted consumers and expunging of consumers' adverse records; the exemption of some transactions from the Act; regulation of credit bureaux; and the separation of power between the tribunal and courts. The disagreements on these issues illuminated the competing interests of the different stakeholders (politicians too) and reflect the one-sided struggle (of business-interests groups) in the acceptance of the final legislation.

2.4.2.1 The complexity of the Bill

Retail and micro-credit providers had complained about the draft legislation being too long and complicated for a layman to fathom. They feared that it would be too hard for consumers and credit providers to become conversant with their rights and responsibilities as stipulated by the different provisions of the legislation (curiously, none of the consumer-interests groups raised this issue). It had also been argued that the draft law did not conform to the

standards of a good law in terms of clarity and preciseness as based on the good law checklist (as was read out by the Law Review Commission during the public hearings).⁷³

Responding to this, the DTI pre-empted the discussion by conceding that the Bill was indeed complex, but maintained that the complexity was balanced with a plain language draft and that its length was necessary to limit undue discretion being given to the minister and the regulator (NCR). The DTI also indicated that as a solution to deal with the complexity issue, the NCR was mandated to initiate education programmes for consumers (Ms Ludin – DTI’s the Deputy Director-General of Consumer and Corporate Regulations). The opponents then pointed out the toll this would put on state in terms of investment in resources and infrastructure for this purpose.

Still on the issue of language, the DTI’s assertion that the Bill was drafted in ‘plain language’ had been widely challenged, which set Ms Ludin on the defensive, claiming that the technical issues had to be presented in complex technical terms and that ‘it was not always possible to reduce everything to its utmost simplicity’. Further defence of the complexity issue was offered by Mr Davel (DTI)⁷⁴ who claimed that the British and Australian credit legislations were vastly more extensive. With this defence provided, the DTI saw no cause to make adjustments in regard to the complexity issue and none were made.

Fast-forward to the final product and practice (2 years after the NCA came into force): research conducted on behalf of the NCR between February and May 2009 seems to give credence to this fear. It was found that the level of awareness of the importance of the NCA and NCR was very low amongst low-income consumers; there was a general lack of knowledge regarding credit terminology, especially regarding information consumers need to know when entering into credit agreements; and most respondents, especially from low-income groups, did not know what to do or where to go when they had a complaint or when they experienced problems with their credit agreements (Rudo Research, 2009).

⁷³ See; Good law checklist presented by the Law Review Project during hearings on the Bill in the portfolio committee available on; www.pmg.org.za.

⁷⁴ The then CEO of the Micro-Finance regulatory Council (MFRC) and current CEO of the NCR.

2.4.2.2 Emergency loans

The ‘emergency loans’ provision (§ 78(2)b) was the main issue of real opposition from consumer-interests groups (i.e., the Black Sash, COSATU, the FSCC and the Rhodes University Legal Aid Clinic), yet business remained reticent whilst the politicians in the Committee did not seem to have a particular direction as to this issue. The common argument was that exempting emergency loans from the judgement of reckless credit granting would create a huge potential for abuse because micro-loans could be dressed up and consumed as emergency loans and lenders would escape prosecution for reckless lending.

The opponents thought that such an exemption would create a loophole for unscrupulous lenders to exploit, and had called for an outright elimination of the word from any sections of the Bill, arguing that such a provision is far removed from the South African socio-economic milieu where emergencies are almost a normal way of life (Black Sash). COSATU had reasoned that such loans were not necessary since they were dealt with by the Social Relief of Distress grant, Disability grants, the Compensation for Occupational Injuries and Diseases Fund and the Disaster Relief Fund. Some opponents charged that this provision was an attempt to usurp the duty of the state, while others contemplated that such loans would only contribute to the burdens of those already facing emergencies.

Microfinance South Africa (MFSA) – the only lending industry representative who commented on the issue – was in support of the provision on emergency loans but they were opposed to the proposal by Mr Rasmeni (ANC) to cap the interest rates on such loans instead if the provision were to be retained – which they also opposed.

The DTI was largely unmoved by the opposition to the ‘emergency loan’ provision, but offered a concession in which the concept of emergency loans would be retained, but amended to limit unforeseen consequences and stated that ‘if the Bill succeeded in the reduction of over-indebtedness, the need for emergency would diminish’. Hence the definition was amended to eliminate the phrase ‘any other unanticipated life event’, and a few parameters were defined including requirements for documentary proof whenever such

credit is to be extended and for the credit provider to indicate the nature of the credit agreement when registering it with the Register.⁷⁵

2.4.2.3 Amnesty from the blacklist and expunging of records

Debates had ensued on the issue of amnesty for blacklisted consumers during the public hearings. Ms Booley (19 August, 2005) had even proposed a once-off forgiveness of all debt for the blacklisted individuals. This proposal resonated loudest among consumer-interests groups who motivated that people were getting ensnared in the debt trap when they borrowed for essentials like school fees and therefore it was the legislator's responsibility to relieve them through an amnesty. With regards to expunging consumer records from credit bureau, the proposal was that records be completely expunged from the bureau databases so that blacklisted debtors may have a clean slate. Others suggested that only adverse records should be expunged as it was important to have a credit history. This was supported by two members of the Portfolio Committee (Mr. Rasmeni - ANC and Mr Stephen - UDM).

Those from the credit industry, especially credit bureaux and debt recovery agents, were predictably opposed to the idea of any sort of amnesty or expungement. They argued that this would make assessment of risk very difficult and would increase credit constraints as lenders would have no information on which to base their decisions. This argument was supported by Dr Nkem-Abonta (DA) during deliberations on 14 September 2005, he insisted that 'as long as the information was predictive it had to be kept'. He noted that expunging records would make credit providers more conservative and would increase the cost of credit to such an extent that good payers would also be victims to the cautious and restrictiveness of the lenders if there was no negative information to distinguish between good payers from bad ones.

In its concession, the DTI responded that although the kind of amnesty proposed by consumer interest groups could not be implemented, there were certain amnesties contemplated by the

⁷⁵The following clause was included: 'provided that any credit extended in terms of paragraph (a) to (c) is reported to the National Credit Register in the prescribed manner and form, and further provided that in respect of any credit extended in terms of paragraph (b), reasonable proof of the existence of the emergency as defined in section 1 is obtained and retained by the credit provider.'

draft law. These would take the form of amnesty for inaccurate information; expunging of default information of amounts under R100 within three months of the Act coming into force, and that information of debts older than three months had to be deleted as a once-off measure. Since the Act's implementation, two amnesties have been offered and the credit industry reports that many of the issues they warned about actually materialized following the first amnesty.

2.4.2.4 Exemption from the Act

Some sectors of the industry wanted to be exempted from the Act. These included cellular phone companies; the National Student Financial Aid Scheme (NSFAS); and medical aid providers. Cellular phone companies had argued that due to the nature of the cellular industry, they did not have many credit agreements with customers. They thus did not contemplate any need for consumers to be protected from them especially since their services did not include finance charges. The NSFAS had argued that it was a special case and deserved to be treated as such and be exempted from certain provisions of the Act, if not all.⁷⁶

For the cellular service providers, their cause was not helped by the reprimands they received from members of the Committee during their submissions on 17 August 2005. They were accused of exploiting their customers; customers not being able to get out of contracts (Dr. Nkem-Abonta - DA); hiding phone costs in service charges and 'pressure selling' (Prof. B. Turok – ANC; Mr. S. Rasmeni - ANC). These charges were denied by Vodacom's Executive for Special Regulation (Ms. V. van Zyl).

The DTI responded on 7 September 2005. In respect of the cellular service providers, the DTI argued that all consumers had to be protected in all circumstances and across the income spectrum and that it was necessary to regulate incidental credit (cellular phone credit would fall under incidental credit) but to a limited degree. As for the NSFAS, (following an assertion by Ms. M. Mpahlele (DTI) that the importance of developmental credit providers was recognised by government), Ms Ludin (DTI) informed the Committee that sections 148(2), 69 and 89(2) were amended in line with NSFAS's request and that developmental credit was

⁷⁶ They wanted to be exempt from provisions of sections 62, 65, 69, 89(2), 90, 92 and 104.

exempt from certain provisions of the law. Section 69 was amended to reduce reporting requirements on developmental credit providers, while section 89 (2) was amended to allow unemancipated minors to conclude credit agreements with the consent of their guardians.⁷⁷

2.4.2.5 Regulating credit bureaux

Following the outcry from consumer-interests groups that credit bureaux were pervasive and some arguments from the industry that most market deficiencies were emanating from the lack of viable information and reporting infrastructure, members of the policy committee presented their own criticisms. They felt that credit bureaux traded consumer information with impunity (Mr Rasmeni - ANC); they published prejudicial and potentially defamatory information (Mr Stephen - UDM); there was not enough transformation in credit bureaux; some of their officials had bad attitudes and there was 'too much judgmental thinking' (Ms F Mohamed - ANC) and that they had no mercy for poor people (Ms Ramodibe - ANC).

On a defensive (10 August, 2005), the Credit Bureaux Association, the TransUnion ITC credit bureaux and the South African Chamber of Business (CBA) asserted that such accusations amounted to a misconception about how credit bureaux work due to a lack of knowledge about the workings of the credit industry. They explained that, while most people blamed credit bureaux for blacklisting consumers, it was indeed credit providers – and not the credit bureaux – that were responsible for blacklisting consumers. They clarified that the bureaux only reported information given to them by credit providers and that blacklisting occurred simply because consumers failed to satisfy their financial obligations. The credit bureaux also indicated their opposition to the requirement that they had to verify the accuracy of any information reported to them (§70 (c)), arguing that it is practically impossible due to the huge volumes they have to handle yet they receive the information from third parties.

Mr Labuschagne (DA) offered some rare support to credit bureaux from the committee, insisting that these were fine institutions that assisted the credit industry in managing the risk inherent in the consumer credit market. He challenged other members to compare reckless

⁷⁷ It is assumed that the NSFAS anticipated a situation where minor students have to enter into credit agreements with the NSFAS at their institutions of learning in the absence of their guardians.

borrowing by consumers with reckless lending by credit providers. The Law Society of South Africa also submitted that these institutions were important in expediting litigation processes related to credit.

The DTI acknowledged that South African credit bureaux did not comply with international best practice in handling and sharing information, indicating further that, due to their considerable importance to the operation of the credit market, strong regulations had been proposed. The DTI further motivated that regulating credit bureaux had been a major policy objective of the credit law reform in context of promoting responsible contracting and access to credit among the underserved part of the population. They argued that lenders' willingness to lend had to be induced by implementing an effective information sharing infrastructure and noted that this would help in the prevention of over-indebtedness as lenders would have easy access to borrower information on which to base lending decisions.

Regarding section 70, the DTI indicated that they acknowledged the difficulty of verifying the information and the section was amended to remove the clause that would make it a criminal offence to provide inaccurate information,⁷⁸ but the substantive provisions stood.

2.4.2.6 The tribunal versus court

On 8 August 2005, Magistrate Von Reiche (Pretoria Magistrates' Court) had stated that the proposed Bill offended the Constitution by introducing the National Credit Regulator, the Consumer Tribunal and other institutions and that it usurped the power of the Court and 'also discarded experience and legal certainty secured by legislation of long standing such as the Usury Act'.

Some members of the Committee had reservations about allocating certain functions to tribunals which would have been pertinently performed by the courts. Mr. P. Nefolovhodwe (AZAPO) and Mr. M. Stephen (DA) had argued that this would create more administrative and procedural hurdles for poor consumers. They also noted their reservations on the

⁷⁸ Subsection 70(6) was amended to remove provisions for criminal sanctions in the event that inaccurate information is provided by bureaux and was rephrased to reflect that this is only an offense in the event of '...[F]ailure to comply with a notice issued in terms of this section'.

accessibility of the tribunals since, unlike the tribunals, there were courts in every district. The NSFAS had also expressed unease and had requested that section 148(2) be amended to permit all decisions of the tribunal to be appealed rather than just taken on review by the High Court.

In its reply (16 September 2005), the DTI stated that the Bill had been approved by the state's law advisors and that the Constitution contemplated the existence of independent tribunals to perform certain similar functions. It also indicated that there were directives from the Justice Department to have a 'dual system' in which courts dealt with the application or interpretation of the law and exclusive areas of jurisdiction, whilst the tribunal would deal with administrative matters, findings of fact and upholding consumer rights. Aggrieved parties, however, reserved the choice to bring a matter before a court or the tribunal. The DTI indicated further that allocating certain functions to tribunals rather than the court was in principle motivated by the need for public convenience, efficiency or improved access and the desirability of a less formal process – giving regard to the nature of the parties and the relatively routine procedural nature of a dispute.

The DTI also admitted that while they were aware of the possible accessibility issues, the law would allow a single tribunal member to go directly to where the dispute was and hear the dispute. Nonetheless, the DTI envisaged a situation in which the credit regulator and other alternative dispute resolution (ADR) institutions would deal with most of the matters without even requiring courts or tribunals.

All in all, these arguments and counter arguments did not have any substantive effect on draft Bill. In judgement, these deliberations did not represent a typical exercise of legislative consideration of what was to be a very important law. For the politicians largely sided with consumer-interests groups, chastised the credit providers while credit providers argued in vain for concessions. The DTI was hardly taken to task by the members of the Parliamentary Portfolio Committee who seemed to be in agreement with the entire draft law. The DTI was content with the defence it provided on most issues, such that only a few technical issues were reviewed and tightened by amending the language in some clauses. On 7 October 2005,

following these deliberations, the DTI (represented by Ms A. Ludin and its Law Advisor, Mr J. Strydom) presented the final proposed amendments to the National Credit Bill to the Portfolio Committee chaired by Mr. B. Martins (ANC). The committee unanimously adopted the Bill with the amendments.

2.4.3 Concluding remarks

The Technical Committee which was mandated by the DTI to undertake a credit law review and examine the problems that were facing the credit market had identified a number of weaknesses in the legislation, including inadequate disclosure of credit cost; incomplete credit bureaux information; inconsistent and fragmented legislation, all of which, created incentives for reckless credit behaviours and predatory lending. Another insight from the Committee was that the credit policy was too fixated on price control. As such, a completely new credit legislation and policy had to be implemented and that the focus had to shift from price control to consumer protection against over-indebtedness. Regulating undesirable lending practices, disclosure of credit terms, consumer education as well as credit bureaux activities had to form the cornerstone of the new legislation. These proposals formed the basis of the National Credit Bill.

The competing interests of the stakeholders were highlighted during the public hearings in the Trade and Industry Parliamentary Portfolio Committee. The business-interests groups had greater opposition to the draft law while consumer-interests groups were in agreement, with only minor concerns. The consumer-interests groups recounted stories of abuses in the market that they thought were perpetuated by the under regulated credit providers, credit bureaux and debt collectors – most of which, had been noted in the 2002 Technical Committee report. Most of the issues highlighted by this group had, for the most part, been catered for in the draft legislation. It is not surprising then that the consumer-interests groups endorsed all the provisions of the bill from the very beginning – except the provision of ‘emergency loans’ and a few clauses in the debt counselling provision.

The representatives of the credit industry acknowledge that there were problems of over-indebtedness and credit discrimination. However, they blamed these on the lack of a viable

credit information infrastructure and registration. Intuitively, they welcomed these provisions of the draft law, but expressed far more dissatisfaction with the bill. It was clear from their submissions that they were more comfortable with the way things were and felt that the proposed legislation had unwelcome costs and process implications for business and was overly biased towards consumers. A number of concerns cited by this group include, the stringent credit assessment requirements; the lax debt enforcement provisions; cumbersome provisions on rescission and termination of credit agreements; and interferences in the credit pricing and interest. They also felt that the draft law did not cater appropriately for asset-based finance as had been the case under the old regime.

The deliberations in the Portfolio Committee were largely about stating the case for tighter regulations and finding value for consumers. This could explain why issues such as disclosure, debtor amnesty and interest rate control reverberated so loudly during these deliberations. Needless to state though, the law was intended to protect vulnerable consumer not only from reckless profit-seeking lenders but also from their own irrationality. Indeed, it was the DTI and the ANC government's long held case that consumers (especially the black majority) had suffered from years of exploitation by lenders while a vast majority were shut out of the mainstream credit market and driven to borrow from dangerous underground lenders. So it is not surprising that the substantive objections from the business-interests group were not acceded to by the DTI.

Ultimately the initial version of the draft law did not change substantively, perhaps because it satisfied the main issues demanded by the consumer-interest groups which included the ANC's important allies (COSATU, SACP): i.e., tighter regulations and controls on pricing – both of which would represent value for consumers. In summation, the consumers could well consider themselves the relative victors here. However, in retrospect, a great deal of value was created for credit providers as the law clearly streamlined the lending business better than ever before. For instance, elements such as the creation of an effective information reporting and disclosure infrastructure should benefit lenders in terms cost reduction and reduction in the incidences of default losses. Ultimately, the mutual benefit can be framed in

terms of market expansion which means increased access to credit among those formally excluded. On the side caution though, the market expansion could also be self-defeating if marginal borrowers are allowed to over-extend themselves.

Based on current policy debates around the world in relation to consumer credit regulatory reforms, it is possible that Government's action was justified. It is argued that it is possible to provide meaningful consumer protection and still expand access to credit with policy measures which recognise the centrality of the credit market and the need to empower consumers through access to affordable credit; effective sanctions against fraudulent and unfair practices, and address the causes and consequences of over-indebtedness. The latter can be achieved through a variety of measures that range from facilitating consumer education and information disclosures; control on unfair terms in credit contracts; lender liability for irresponsible lending (Ramsay, 2004; Porteous, 2006). Most of these issues had, to some degree, been catered for in the draft law which made it a great improvement from the laws it meant to replace. One might even venture to state, that the South African regulatory authorities followed international best practice in designing the law. Current developments in regulatory interventions to 'prevent' consumer over-indebtedness speak to promoting responsibility in the credit market and addressing the imbalances in negotiating power between consumers and credit providers. The NCA offers modern tools to this effect and the following subsection discusses the key components of NCA in the context of prevention of over-indebtedness.

2.5 The key components of the National Credit Act

The NCA aimed to achieve its consumer over-indebtedness prevention objectives by, among others, promoting responsibility in the credit market and addressing and correcting the imbalances in bargaining power between consumers and credit providers. For this purpose, the Act introduced provisions for, inter alia, discouraging reckless credit granting, enforcing adequate disclosure of credit information to aid consumers' decision-making, and consumer education regarding credit and consumer rights (NCA § 3). To oversee efforts towards these objectives, a strong and paternalistic regulator had been recommended in form of the

National Credit Regulator (NCR). This section analyses the key components of the Act that reflect the consumer protection objective in the context of ‘prevention’ of over-indebtedness (the discussion of provisions aimed to ‘alleviate’ indebtedness already incurred fall out of the scope of this sections but is covered in Chapter 6). The issues discussed relate to the protection prior to entry into a credit commitment and include the NCR and registration provision; the disclosure requirements and information sharing, reckless lending and over-indebtedness, as well as consumer education. These issues are discussed against a background of some recent developments in prevention of over-indebtedness from the financially developed world (see subsection: 1.3.2.3).

2.5.1 The NCR and the registration requirement

Section 12 of the NCA established the NCR, a juristic body subject to the constitution and the law with jurisdiction throughout the country and responsible for the regulation of the entire South African consumer credit industry. The regulatory functions of the NCR as contemplated in section 14⁷⁹ of the Act are extensive and include the registration of credit providers, credit bureaux and debt counsellors and the maintenance of registries of all persons registered in the Act (§ 53). Other generic functions of the NCR include developing a competitive and accessible credit market,⁸⁰ enforcement of the Act,⁸¹ and research and public information on matters of credit⁸² as well as reporting to and advising the Minister⁸³ on policy matters regarding the credit industry (§18).

The emphasis on registration of credit providers, credit bureaux and debt counsellors is well reflected in the ANC government’s strong predisposition towards registration and regulation, while contemporary credit regulatory regimes put a strong emphasis on registration in order to promote industrial responsibility. The intentions of the legislators in this case are clear: elimination of underground credit activity and impunity and possibly a means for the

⁷⁹ Read with the National Credit Regulations 4 to 8 (GG No. 28864).

⁸⁰ Section 13.

⁸¹Section 15.

⁸² Section 16.

⁸³The ‘Minister’ in the Act refers to ‘the member of cabinet responsible for consumer credit matters’ Government Gazette 28619, 2006, Pg: 22).

regulator's revenue.⁸⁴ In addition, stringent conditions have been brought to bear on those applying for registration,⁸⁵ including a commitment to combating over-indebtedness – although no clear guidelines are clarified in this respect. In the case of debt counsellors, certain educational, experiences and competences have to be considered as well. Also, in an attempt to avoid possible conflict of interest, fraud or industrial collusion, a person involved in other credit activities (e.g., debt collection, credit bureaux operations, a credit provider or an employer thereof), is ineligible for registration as a debt counsellor.

Registration of these industry players has consumer protection implications in that it opens up possibilities for consumer redress in the event of wrongdoing by these institutions (makes the culprit easier to track down). Registration also makes it easy to track information on the operations and trends within the credit market. Such information may be vital for public knowledge, and policy reforms.

These objectives might, however, be compromised by caveats related to enforcement and inconsistent regulation. While the NCR is empowered to evaluate and register credit market institutions, it does not have the power to withdraw or de-register anybody registered with it (Vessio, 2008). Registrations may only be cancelled by the National Consumer Tribunal at the request of the NCR upon investigation of allegations of unlawful or prohibited conduct of the registrant (*ibid.*: 232). This poses administrative hurdles with implications for efficient enforcement of compliance and responsibilities of the registrants.

Problems might also result from the inconsistent threshold determination of registrants. The Act applies to all credit agreements, whether the credit provider is registered or not. Yet the Act states that to be registered as a credit provider, the person or an associated person must have more than 100 outstanding credit agreements (excepting 'incidental' credit agreements⁸⁶) or the total principal debt owed to such provider under all outstanding credit

⁸⁴Sections 40(3), 43(2) and 44(2); Section 51 provides for payment of an application fee, as well as initial registration fees (upon registration) and annual renewal registration fees.

⁸⁵ Section 48.

⁸⁶ Section 40 (1).

agreements should exceed a certain threshold determined by the Minister.⁸⁷ The inconsistency in this regard is that credit providers are prohibited from conducting their businesses unless registered under the Act yet sections 40 and 42 seem to suggest that as long as lenders' outstanding credit agreements are below these thresholds, they are not bound by the registration requirement. Many micro-lenders might face a dilemma under this scenario, given that they usually operate with very little capital and their debt books are usually small. While it might appear that micro-lenders operating below the threshold may not be required to register, they will have no recourse in the event of default if unregistered. As such, they might find it safer to continue operating underground.

The regulation provision is also inadequate in that while it is illegal for an unregistered credit provider to extend credit, it is not illegal for a consumer to take credit from an unregistered credit provider. This means that even though the supply of unregulated credit is prohibited, the demand for this type is not. The consequence might be that the demand for unregulated credit will create its own underground supply as long as there are no sanctions for consumers who use the services.

It is worth noting that while the NCR and its attributes are a great improvement, in practice, this regulator has been overloaded with functions (that could be performed by other agencies) given its extensive mandate and its reach and the relatively small staff complement.⁸⁸ There is also the fact that all queries have to be directed to their head offices in Johannesburg. The capacity of the NCR to perform all those functions satisfactorily is continually called into question. To allow for speedy delivery it should make sense for the regulator to consider opening satellite offices throughout the country – especially since, as Vessio (2008) points out, there are always unanticipated administrative matters arising in each specific province (and requiring urgent attention).

⁸⁷ Section 42 (1). This was set at R500 000 for five years from the date of coming into force the enabling sections of this clause – 1 June 2007.

⁸⁸ Sixty-six permanent employees, four contract workers and 17 others contracted via employment agencies (NCR *Annual Report*, 2008:41). The report further indicates that they intend to increase that number to 94 staff members, which is still a small number given the extensive mandate and the fact that it has to serve the whole of South Africa.

The capacity problem was highlighted in the NCR's impact assessment report of 15 April 2008. In it, credit providers complained that the registration process was too slow: there was very little feedback received on issues that needed clarity; consumers were mostly unclear about their responsibilities regarding over-indebtedness, etcetera. The enforcement capacity problem could also be blamed on the fact that six years on (as reported in the NCR Annual Report, 2012/2013),⁸⁹ many of the old abuses are still carried out by registered lenders including retention of bank cards, pins and identity documents, lending without affordability assessment, overcharging, etcetera.

2.5.2 The disclosure requirements and information sharing

The disclosure and information sharing provisions of the NCA are activated by sections in chapters 4 and 5 of the NCA and chapters 3 and 4 of the National Credit Regulations. The theoretical foundation of the legislation enabling lenders to exchange information about borrowers can be traced to the arguments that if the information is exchanged appropriately and used properly, it can be a robust deterrent for consumer over-commitment while increasing accessibility to cheaper credit. This is so because, it would also improve lenders' knowledge of potential customers' characteristics in order to reduce adverse selection problems; reduce the informational rents⁹⁰ that lenders could otherwise exact on consumers; reduce reckless borrowing, by preventing over-burdened consumers from taking on more commitments; and to eliminate the borrowers' incentive to draw credit simultaneously from different lenders without any of them realizing and getting over-extended in the process (Miller, 2003; Love & Mylenko, 2003; Jappelli & Pagano, 2005; Djankov et al., 2007). Consumers who maintain clean records will have more choices in the market since their

⁸⁹ National Credit Regulator Annual Report 2012/2013. Available: <http://www.thedti.gov.za/parliament/NCR2013.pdf> [2014, June 20].

⁹⁰ Jappelli & Pagano (2005), citing Padilla and Pagano (1997); Kalberg and Udell (2003); Using a two-period model where lenders have private information about their clients and therefore have informational advantage which confers some market power to these lenders over their customers, and generates a hold-up problem. When borrowers anticipate that lenders will charge predatory rates in the future, they exert low effort to perform, resulting in high default and consequently high interest rates, and possibly market collapse. However if lenders commit themselves to exchange information about borrowers' types, they restrain their own future ability to extract informational rents, leaving a larger portion of the surplus to entrepreneurs. As a result, entrepreneurs will invest greater effort in their project, resulting in a lower default probability, lower interest rates and greater lending relative to the first period exclusive information.

ratings will be in the domain of the whole market and not exclusive to a single lender (Brown et al., 2008; Semenova, 2008).

Credit information disclosure by lenders to potential borrowers is also an important decision-making aid. It reduces poor judgment by borrowers, and improves rational decision making by allowing consumers to readily compare and evaluate offers before making a commitment (they can then decide whether to borrow now or wait). Consequently the incidences of over-indebtedness and the frequency of arrears are reduced, which benefits both lenders and consumers (McCoy, 2007; Jappelli et al., 2008).

During consideration of the credit bill in parliament, the proponents of strong regulation (consumer-interests groups) had emphasised the need to improve the channels of communication between creditors and consumers and to enforce exhaustive disclosure of credit costs and other terms connected to the credit. Many had complained that the actual cost of credit was often much higher than initially disclosed and, in other cases, the information was frequently false or misleading. They argued that disclosure would enhance competition and aid consumers in making borrowing decision. Although representatives of the credit industry indeed mostly agreed with this view, they were wary of the extra costs and burdens that could result from stringent information sharing regulations.

The DTI had argued for the strong necessity to balance the bargaining power in the credit market which was badly skewed towards lenders. So, in contrast with the old regime, the NCA provides consumers with improved rights regarding information on the cost of the credit and other information regarding contracting⁹¹ and also improves the flow of consumers' information between the different lenders to enable them to evaluate risk. Product representation in advertisements and marketing practises are also affected under this provision.⁹² The regulatory intentions are clear: create an environment where consumers will be able to apply for credit with full knowledge of the consequences of doing so. Whether it

⁹¹ Sections 63, 64 & 65 (read with Regulations 28 & 29). These sections give the consumer the right to receive information in their official languages and all documented information about the terms of the agreements and other documents as may relate to the transaction.

⁹² Sections 76 & 77 (read with regulations 21 & 22).

is to their advantage to take the credit rather than pay cash, whether the cost is worth their while, or whether to buy now or wait.

The Act regulates credit marketing and sales including any product information (or lack thereof) considered to be misleading to consumers and section 74 introduced the concept of ‘negative option marketing’.⁹³ Full disclosure of facts is required in all credit marketing. For instance, the Act now requires that where monthly payment and cash terms are available both facts should be stated and that both the total payable on ‘terms’ and the cash price must receive equal prominence. There is also the pre-agreement quotation⁹⁴ which requires a credit provider to provide the consumer with a pre-agreement statement and a quotation in a prescribed format that is binding on the credit provider for a period of five days to enable the prospective customer to make comparisons between different offers on the market.

The NCA also introduces the national credit register (to constitute a national database of all credit transactions) and regulates credit bureau operations. The objective being to create viable infrastructure to enable information-sharing between lenders so they can cost effectively evaluate the risk profiles of prospective customers. Currently, the Act requires that all credit agreements be reported either to the NCR or to registered credit bureaux.⁹⁵ Holding information is tightly regulated to the effect that this information may be released only for specific purposes and to specific parties and consumers must be informed before any adverse information is supplied to a bureau and consumers may access their information free from the bureaux.⁹⁶

A potential caveat for the information and disclosure provisions relates to the apparent supply side over-regulation and demand side under-regulation. Although consumers are equally required to disclose information, no definitive standards are set regarding the amount of

⁹³ The law provides for three forms of ‘negative option’ marketing. A credit provider for instance must not make an offer to enter into a credit agreement or induce a person to enter into a credit agreement on the basis that the agreement will automatically come into existence unless the consumer declines the offer (§ 74(4)).

⁹⁴ Section 92.

⁹⁵ Sections 60 & 70 (read 70 with regulation 19).

⁹⁶ The consumer has the right of free access to records relating to him and may request information to be corrected or disputed information to be blocked. Information compiled by credit bureaux is confidential and may not be disclosed to anyone without the consent of the consumer or by an order of court or the Tribunal (§ 72).

information consumers are supposed to supply about their social and economic circumstance and while most economic characteristics might be visible to lenders, there might be other invisible information that might be vital for ample assessment of credit risk. In practice, there are no set standards to judge whether consumers received adequate and clear information or not: while lenders can provide the necessary information, understanding and absorbing the information by consumers is another issue. Lenders might not have the willingness and/or resources to engage in consumer education programs that would otherwise enable consumers to understand credit issues. A certain level of financial literacy might be required and thus would need to be supplied independently of credit providers.

Theoretically, stringent reporting requirements on lenders might also threaten their competitiveness and lead to negative outcomes. A basis for this contention is provided by Semenova (2008) who argues that stringent reporting requirements do not completely remove information asymmetries from the market because lenders tend to lose their competitive advantages and clientele due to information sharing, and may sometimes act dishonestly by reporting falsely about their clients in order to retain them. Section 72, which gives consumers the right to access and challenge their credit records, may perhaps be an antidote to such a scenario. However, many poor, illiterate people or those in remote locations may not be in a position to access and challenge their records.

Another caveat might be the time delay in moving the information to the required destination. The gap created might be an incentive for unscrupulous parties to abuse the system. For example, the time it takes for a credit agreement to be registered by a credit bureau or the central loan registry so that this information is accessible to all credit providers in the country has critical implications for fraud.⁹⁷ Without a system that reports and records credit transactions in real-time (the very moment a credit agreement is concluded), there may still be incentive for some dishonest consumers to draw credit simultaneously from different

⁹⁷An official of the NCR responsible for research and public information who was interviewed for this study was asked; “how long does it take for information about a credit agreement concluded between parties to reach a credit bureau so that that information can be used by other credit providers who may need it?” He indicated that his office was not aware how long, but suspected it could be between a few days to a few weeks. In this argument, even a few days, is too long.

lenders without any of them realising it. Given the potential for such quasi-fraudulent practices, a technologically astute central loan registry is supposed to be a matter of urgency.

In summation, regulating disclosure and information exchange is the building block of modern credit legislations. It might prove critical for South Africa in improving access to credit, especially among marginal borrowers, and lenders' and debtors' decision-making will be improved. Most importantly, disclosure and information sharing might be critical in reversing the growing problem of consumer over-indebtedness and reducing the incidences of defaults as lenders will have enough information to help them make better lending choices, which should benefit both sides of the market.

2.5.3 Reckless lending and over-indebtedness

Prevention of over-indebtedness is a social policy concern since over-indebtedness threatens the welfare of individuals, households and the society. Over-indebtedness can result from defective market behaviours as well as from unanticipated negative life events. It had been argued that the shortcomings of the old credit legislation had compounded the problem among many South African especially the lower to middle class consumers with limited knowledge of the credit industry. Many were ensnared into commitments by offers of cheap credit and other deceptive techniques with limited to no regard for their capacities to repay. As such many consumers were borrowing beyond their means and, to some extent, many of whom were aware of this fact.

Of course, other factors must have been culpable as well, especially those that could not be helped by either the lenders or consumers, for instance, debtors suddenly falling out of employment, yet with families to feed. Regarding the defective market behaviours, consumers had to be protected both from lenders' opportunism and deception as well as from their own irrationality. Hence, making the reckless lending and over-indebtedness provision very desirable.

The reckless lending and over-indebtedness provision is enabled by Chapter 4, Part D of the NCA and regulations 23 and 24. Under the Act, consumers are over-indebted if – at the time of determination – the available information indicates that they will not be able to satisfy in

a timely manner all the agreements to which they are party, having regard for their financial means, prospects and obligations (NCA § 79 (1) a, b). This provision does not apply to student loans, ‘emergency loans’; public interest credit agreements; pawn transactions; incidental credit agreements or temporary increases in the credit limit under a credit facility (§ 78(2)).

This is closely interlinked with the provisions on information and disclosure. In fact, the reckless lending and over-indebtedness provision, simply enforces a thorough financial assessment of credit applicants (by credit providers) to determine the extent or amount of credit that they can afford before entering into credit contracts. In doing so, a credit provider must determine that the consumer generally understands and appreciates the risks and costs of the proposed credit, and of the rights and obligations of a consumer under a credit agreement; the consumer’s debt repayment history; the consumer’s existing financial means, prospects and obligations; and whether the new credit agreement will cause the prospective client to become over-indebted (NCA § 81(2)a). A credit provider who fails to conduct this assessment or conducts the assessment and the results of assessment indicate that the consumer is or likely to become over-indebted, but the credit provider approves the credit application anyway, such a credit provider will be guilty of entering into a reckless credit agreement (NCA §80(1)). The Act states that, despite any provision of law or agreement to the contrary, in any court proceedings in which a credit agreement is being considered, the court may declare the credit agreement to be reckless, as determined in accordance with the relevant section. In such a case, the credit agreement in question may be fully or partially suspended, whilst the credit provider may lose all or part of the money advanced. The Courts may set aside all or some of the consumer’s obligations to repay the debt under the reckless agreement (NCA § 83).

The Act also requires a consumer to disclose material information fully and truthfully during this assessment (§81. (1)). It is, therefore, a complete defense against allegations of reckless credit if it is established that the consumer did not answer ‘fully’ and ‘truthfully’ during

assessment or the consumer's failure to do so materially affected the ability of the credit provider to make a proper assessment (§ 81(4) a & b).

The opponents of tighter regulations had argued that this provision might result in increases in the rejection rate of applications as a result of the stringent affordability assessment required by the law. They indicated that lenders might be forced to shun high-risk and the less sophisticated borrowers which would amount to a new form of credit discrimination. The proponents had argued that consumers were better-off not qualifying for credit that would see them facing court and repossession a few months down the line. In practice, an increasing trend in rejection rates of applicants has been reported and was attributed to the more rigorous assessment requirements while some credit providers reported experiencing lower rates of new account acquisition since the introduction of these provisions in June 2007 also blamed on the stringent affordability assessment criterion (Hawkins, 2009:2).

It has also been noted that the increasing debt distress among consumers provides incentives for lenders and consumers to enter into credit agreements even where it might not be affordable. It is further argued that consumers are mostly asked by credit providers what their expenses are (but not in adequate detail), both because the lenders are less concerned whether this provision will actually be enforced and because the provision is not tight enough.⁹⁸

The exemption of emergency loans from the application of this provision might also present further weaknesses. As discussed earlier, one cannot easily draw a line between an 'emergency loan' and a regular loan because, it is a normal practice for households to borrow regular micro-loans when they face emergencies.

There is also a caveat in the definition of a consumer's 'financial means, prospects and obligations' (§78(3) a-b),⁹⁹ notably, the definition of a person's financial means and

⁹⁸ Personal Finance (press): Regulators all at sea while consumers drown in debt
Citing Dr. Penelope Hawkins, managing director of Feasibility (March 25 2012). Available:
<http://www.iol.co.za/business/personal-finance/banking/regulators-all-at-sea-while-consumers-drown-in-debt-1.1263000#U-bc5GflpMs> [2014, May 15].

⁹⁹Section 78(3): 'In this Part, "financial means, prospects and obligations", with respect to a consumer or prospective consumer, includes- (a) income, or any right to receive income, regardless of the source, frequency or regularity of that income, other than income that the consumer or prospective consumer receives, has a right to receive, or holds in trust for another person; (b) the financial means, prospects and obligations of any other adult

prospects as a person's 'income, or any right to receive income, regardless of the source, frequency or regularity of that income'. If the frequency and regularity of one's income are not important factors in determining future repayment capacity then, one should qualify for credit on the basis of a transitory income windfall which, might not even last through that particular credit life. The regularity, source and frequency of a consumer's income should be crucial factors, as these are the best indicators of debt sustainability.

Also section 78(3) b) which indicates that the 'financial means, prospects and obligations can also be defined in respect of another family member instead of the applicant ('[T]he financial means, prospects and obligations of any other adult person within the consumer's immediate family or household') might be problematic. It would be more appropriate to assess this on the basis of the individual applicant's financial means, prospects and obligations. Even though families have been known to share debt and, sometimes, repayment (e.g., Hurwitz & Luiz, 2007; Collins, 2008; Daniels, 2004), it may not always be the case. For instance as noted that individuals in South Africa have a tendency to be members of more than one household and at the same time move between households (Seekings, 2008), Some are likely to evade due obligations by moving between households. It is therefore submitted that an individual's financial means, prospects and obligations should be extended to another person only in such cases as a spousal relationship in the community of property.

Nonetheless, the reckless credit provisions are bold, desirable and appear to be a great improvement, at least on the basis of theory. These have a potential to influence responsible market behavior if tightened.

2.5.4 Consumer education

The importance of consumer education and public awareness is underpinned by the idea that education and awareness may reduce the need for on-going supervision as it empowers actors

person within the consumer's immediate family or household, to the extent that the consumer, or prospective consumer, and that other person customarily- (i) share their respective financial means; and (ii) mutually bear their respective financial obligations...'.²

to contract with confidence: it reduces incidences of deception and uninformed actions and ultimately balances the respective bargaining power of actors.

Consumer education is incorporated in the mandate of the NCR. Section 16 of the NCA provides that the Regulator is responsible for increasing knowledge of the nature and dynamics of the consumer credit market and industry. The NCR is also tasked with promoting public awareness campaigns in which consumers can be informed about credit matters, their rights and responsibilities in credit relationships and about the Act's provisions. The Act contemplates that with improved awareness of these dynamics a balance in the negotiating power between consumers and credit providers can be achieved, and consumers will be able to make informed choices, competition in the credit market will improve, access to cheaper credit will improve and, ultimately, consumers will be less likely to overburden themselves with debts they cannot afford to pay.

The importance of consumer education had been well articulated in the DTI's "a policy framework for consumer credit". It had been noted that improved disclosure of information and standardisation of contracts on their own would not be sufficient to ensure that consumers make informed decisions. In fact, these would prove futile if consumers were not equipped with effective knowledge to decipher the information disclosed and the provisions of the contracts they sign (dti, 2004b:27). It was thus, recommended that provisions should be made for consumer education, and with ample institutional and financial support for its implementation. Further proposals in the policy documents included: addressing consumer education both at the adult education level, at lower school level and in work places as well as developing a mechanism for joint contributions by government and industry in education campaigns. While, the extent of compliance with these proposals is difficult to assess, the NCR has made great efforts regarding this mandate and has engaged with the public more than ever before. Still, the Regulator's capacity problems hinder the delivery of these campaigns to all who need them.

2.5.5 Concluding remarks

It can be very hard for a person with serious debt payment difficulties to obtain a home loan, rent a home, obtain new consumptive credits, take out a utilities subscription (e.g., electricity or telephone) or take out life insurance. Many over-indebted consumers face a steady growth of indebtedness, due to compound interest and other charges. Research has also revealed a clear connection between poor or impaired health and over-indebtedness. Many people with financial problems suffer from depression, stress-related illness, and feelings of helplessness. Vigorous action is needed to deal with this social phenomenon. over-indebtedness being a serious threat, not only to the individuals directly concerned but also to society as a whole, a number of legal instruments have been designed for (1) preventing borrowing beyond debtors' means, (2) helping people with payment difficulties and, or (3) clearing the debts of people who are already over-indebted. While the finer details might defer, contemporary consumer credit market legislations around the world set these as their primary objectives. These objective are not lost on the South African National Credit Act either.

South Africa can now claim to have a consumer credit legislation that is on par with international standards, at least in the context of prevention of consumer over-indebtedness. As in many states where reforms have recently been implemented or are being proposed to the consumer credit law (e.g., EU, UK, Switzerland, Canada, Australia, New Zealand, US), the NCA's emphasis is on responsible lending and a balance of power in the credit market. The NCA's provisions on credit reporting and information disclosure, sanctions for predatory lending, and the promotion consumer education underpin this emphasis. Other legislative efforts speak to making affordable credit accessible to all so that consumers may not be overburdened by huge fees. Another improvement is the creation of a single dedicated regulator (the NCR) entrusted with maintaining order in the credit market with functions such as ensuring the registration of all industry actors with the sole purpose to maintaining responsible practices in the market; increasing awareness of the issues related to credit and monitoring trends in the market. Responsible market practices require an unabated exchange of information between lenders and consumers and between the competing lenders themselves. Precisely the regulatory objective is to maintain an environment in which

consumers borrow with full knowledge of the consequences of their actions and only the amounts they will be able to pay back without causing undue financial stress to themselves and their households.

While a few problem areas exist and consumer over-indebtedness continues to grow, further reforms to the credit law may be able to eradicate several of these weaknesses and, possibly, reverse the trend in over-indebtedness. Reforms need to target at least three areas; (1) monitoring compliance and defining fully the perimeters for information and disclosure, (2) improving financial capability, budgeting and money management through public information campaigns; education and advice. There is a need to ensure that skills are developed amongst young people while still in school, the general population and those in any sort of economic difficulties in order to prevent further problems. The third is the need for responsible aftercare service by creditors. Creditors can help to prevent over-indebtedness by providing appropriate payment methods; contacting consumers at the first sign of trouble and being receptive to proposals for renegotiating repayment plans.

2.6 Conclusion

Regulating the credit market is but only part of the evolving policy and political framework for regulating firms in the South African economy to galvanise consumer protection objectives and gains. According to the DTI, these efforts are based on the principle of fair trading and strive to strike a balance between the interests of business and those of the consumers. This should be important, because in this new era of increasing market competitiveness, a convergence between the interests of business and of consumers becomes ever so clear. Most notably, it is in the best interests of both business and consumers that consumers are not over-burdened with more debts than they can pay as this makes such consumers bad and unreliable clients, employees and/or investors, whilst their families will suffer in many different ways due to this situation. As such, the prevention of consumer over-indebtedness should be beneficial to both lenders and borrowers.

The NCA was a bold attempt to correct the market deficiencies caused by the ineffectual credit laws it replaced, but most of all, to provide possibilities for both the prevention of and

relief from over-indebtedness. That way, lenders would be expected to expand lending, especially among marginal consumers, while consumers would also be expected to sustain their borrowing as they would borrow only affordable amounts. There was also the fear that, on the contrary, lenders might feel constrained by extreme compliance requirements and might become even more conservative in granting credit, whilst the demand-side under-regulation might give some consumers incentives to consume beyond their means. There is no evidence to counter or support these arguments and in this regard, it is this dissertation's submission that this analysis would be stronger if these issues had been investigated in practice. However, time and data constraints made this impossible, therefore it is seen as an important area for future research.

On the basis of contemporary policy and academic debates in the area of consumer credit regulation as well as developments in the financially-developed world, the NCA and its regulations seem well positioned to protect consumers from reckless lenders, prevents uninformed use of debt and exploitation by lenders. The Act's provisions on registration; disclosure and information; lenders' liability for recklessness; consumer education; fair pricing and redress for abusive practices, are great improvements from the old regimes and are akin to the tools offered in the financially-developed world. These might offer better promises for consumer protection compared to its predecessors.

At the moment, it is less clear whether lenders and consumers feel a real improvement from the old regime and whether their respective positions have been improved. During consideration of the law in the Portfolio Committee, they assumed positions favour. This meant that submissions from the stakeholders became an exercise in the protection of their own interests. It was a conflict in which lender interests were pitted against consumer interests, – with the backing of policy makers who had already made up their minds that consumers needed real protection, had the right to access cheaper credit, and needed some form of redress for past 'abuses'. Thus, consumer-interests groups found the draft law satisfactory from the onset while, lender-interests groups were largely opposed as they found

the draft law to be overly consumer-friendly. Still, no concessions were forthcoming for this group.

Because the debates in the Portfolio Committee did not affect the substance and form of the draft bill, this dissertation submits that the process of the policy formulation can be linked with the outcome of the legislation only through the events that happened between 1992 (South African Law Reform's review of the Usury Act) and October 2004 when the DTI organized two workshops to "inform the bill". Such events include, among others, the 1999 National Small Business Regulatory Review; 2001: Policy Board for Financial Services investigation into SME finance; the 2002 Committee's proposals on the policy direction; the drafting of the 'Policy Framework for Consumer Credit' document and the subsequent feedbacks requested on the document and the drafting of the actual bill. The actions in parliament can be seen as merely following policy-making protocol.

In spite of this, South Africa can now claim to have a consumer credit legislation that is on par with international standards in the context of prevention of consumer over-indebtedness. All the nine chapters of the Act emphasise consumer protection in one way or the other either through new avenues for consumer bargaining power and/or aiding consumer decision-making. These seem to be significant and proper. Contemporary credit market regulatory regimes place greater emphasis on credit reporting and information disclosure as the first and main steps towards responsible lending. Credit reporting and exhaustive disclosure of credit terms as highly recommended by the recent EU Directive (CCD 2008) designed for EU Member States. These are well articulated in the NCA. Most importantly, the NCA emphasises the applications of strict and sensible criteria to ensure lenders only lend affordable amounts to consumers with clear statements. It could do more, by actively encouraging lenders or other designated authorities to initiate amicable agreements with consumers when they start having difficulty managing their debt situations. It is less likely though that the profit-oriented lenders will be willing to engage in that kind of aftercare service given the time and resource limitations. What is practicable however, is tightening loopholes within the information and disclosure and affordability assessment provisions,

complemented by tougher sanctions for noncompliance thereof, and aggressive monitoring of compliance at the contract entry level.

More broadly, these regulations can potentially have a long-term positive effect on the entire market. Periodic independent assessments of improvements in compliance, the NCR's performance against objectives and trends in indebtedness should be commissioned. Other policies and legislations may be required to tackle other weaknesses in the market and society that may not fall within the ambits of credit contracting and sales. Policies that speak to social welfare, personal income, education and employment may also be just as important in preventing over-indebtedness. Note that over-indebtedness can result from a multitude of factors other than market behaviour.

In practice, anecdotal and documentary evidence suggests many of the old problems have not gone away. Notably, many consumers and credit providers do not know or understand how the legislation affects their relationships whilst, the Act's enforcement capacity and the lack of a clear consumer education agenda have also been called into question. The monitoring capacity of the regulator is still questionable at best, and the level of compliance is still unknown at worst. Currently, these issues come to attention only when a problem arises. For instance, the NCR (in its 2012/2013 Annual report) reports serious abuses even by major reputable lenders including reckless credit granting.

Further evidence suggests that the government's policy of easy access to 'cheaper' credit may not be so desirable after all. This is especially so, because many consumers are ignorant of their rights under certain arrangements and lenders are willing to exploitation any loopholes in the law. Experiences suggest that there is a new form of exploitation of consumers by lenders and it all seems legal. It is the new middle class (the so-called 'black diamond') that seems very vulnerable to the new ways. Conspicuous consumption against a background of very little knowledge about money in general and credit management in particular has become the bane of these.

Many younger and often new entrants into the job market (and others) have almost unlimited access to credit as long as 'the available information' shows that they can maintain their

monthly debt repayments (in fact that is the only requirement under NCA). The problem, however, is that while they might manage their required monthly instalments, they are often left with nothing to save for when an urgent need arises. Many in the middle class continue to live ‘hand-to-mouth’ and that is legal under the current laws. A situation such as that will clearly have negative implications for asset building, old-age wellbeing and possibly even crime. On this note, this dissertation proposes tightening the over-indebtedness definition by putting caps on the monthly repayment-to-income ratio beyond which one should not be allowed to access more debt and more stringent affordability testing criteria be implemented – note that affordability was never an issue for the most ardent campaigners for easier access to credit and against credit discrimination (especially the influential partners of the ruling party COSATU and SACP). All in all, more education about financial management and consumer rights should also come in handy.

Evidence suggests that the interaction of other laws (notably the Magistrates’ Courts Act 32, 1944 and the Magistrates Courts Rules) is undermining the NCA. For instance, garnishee orders and emoluments attachment orders are still issued under the Magistrates’ Courts Act, which is in direct contradiction with the provisions of the NCA. Anecdotal evidence suggests wide-ranging irregularities in the obtaining, issuing or serving of these orders. Especially worse if the victim is illiterate. In this respect the dissertation submits that there is an urgent need for the removal of overlapping regulations in terms of consumer debt. All issues connected to consumer debt should be dealt with under the NCA.

There is also evidence to suggest that experiencing debt problems is always tied in with the reasons why people choose to use credit in the first place, or why lenders are more willing to lend to certain ‘types’ of households or consumers and not to others. For that matter, future regulatory reforms for effective prevention of over-indebtedness and its associated problem should be mindful of the fact that some consumers are more likely to use debt than others, and that some consumers are more likely to fall deeper into debt than others. This also creates new avenues for research. As such, the next two chapters will analyse these issues with the hope that implications for policy-making and consumer education can be forthcoming.

Chapter 3: Participation in the consumer credit market

Abstract

This chapter analyses the determinants of South African households' participation in the consumer credit market before the enactment of the NCA. The analysis is based on the notion that even in an under regulated market, lenders will try to avoid default losses such that participation in the consumer credit market is driven by present and expected future resources. Life-cycle or shock induced consumption needs might play a role as well, thereby blurring the line between recklessness and rationality. The Cape Area Panel Study (CAPS), a longitudinal study conducted between 2002 and 2006, is employed to test this. The logistic regression analysis revealed five factors (family size, dependence, marital status, age and increase in expenditure) that have a positive relationship with the incidence of indebtedness. Current income and positive perceptions of wellbeing also played a positive role. The findings suggest that the factors affecting the incidence of indebtedness are more complex than hypothesised – consumer credit behaviours seem to be more than the aggregation of the lender's and/or consumer's individual decisions. Nonetheless, the results of the logistic regression analysis indicate that households were borrowing either because they had the ability to repay or simply to ease budgetary pressures. This is not evidence of the kind of reckless credit behaviour that was widely reported. Hence, this analysis contributes to the literature by highlighting that even in the absence of appropriate regulations, lenders will always attempt to behave rationally in order to guard against default losses and therefore the importance of tighter regulations on credit access might be overstated.

Key words: Ability to consume; Consumption needs; Creditworthiness; Debt participation, Consumer debt; CAPS

3.1 Introduction

It has been noted earlier that since the mid-1990s, South Africa experienced an unprecedented growth in consumer indebtedness in terms of the absolute value of debt held, the stock of debt relative to income and the number of indebted households. This trend was blamed on the weak regulatory environment that permitted reckless lending and (to some extent) borrowing practices, together with the social-economic changes that entailed the growth of household incomes and the expansion of the consumer credit infrastructure.

This part of the dissertation reveals the people behind the statistics, looking closely at the patterns of debt participation among South African households before the introduction of the current consumer credit regulations in order to determine the factors that were driving participation in the credit market. Given the widely reported unregulated lending characterised by reckless credit activities during this period, it might be assumed that factors related to creditworthiness such as income would not be as important in determining participation in the debt market. Instead, borrowing would be a random activity by households with a willingness to do so, regardless of their objective ability to repay. The second insight relates to the role of the consumer credit as a complement to low incomes or a substitute for income support. In this regard households might borrow simply to bridge consumption – especially when available resources cannot meet current needs – (i.e., attempting to make ends meet in times of risk). This then blurs the boundaries between rationality and recklessness.

In a responsible credit environment, it is assumed that when consumption needs arise, consumers apply for debt and lenders choose whether to approve or reject the applications based on visible characteristics that indicate the applicant's ability to repay. Lenders will consider many factors in reviewing the credit application of a potential borrower and such factors will affect both the incidence and level of debt. Such factors may include the level and stability of the applicant's income, employment status, and physical or financial assets, among others. In addition, there are consumption needs (or budgetary constraints) that might

force households to apply for credit in the first place. Thus the incidence and/or level of household indebtedness is both a function of borrowers' demands and the lenders' assessment of borrowers' future ability to repay.

Upon this background, the dissertation attempted to examine whether households' use of debt was related to their 'ability to borrow' and/or their 'consumption needs'.

The idea of a household's ability to borrow is based on the stream of literature on 'willingness and ability to consume' (Katona, 1960; Katona, 1975; Kumar, Leone, & Gaskins, 1995; Roos, 2008; Zhu & Meeks, 1994). According to these studies a consumer's discretionary expenditures are a function of both an ability to buy and a willingness to buy. Ability to buy is characterised primarily by the consumer's income during the period in which the discretionary expenditures are to be made and also by the assets of the consumer – both liquid and illiquid assets. The 'willingness' to consume is the subjective component, dependent primarily on attitudes and expectations about personal finances and a willingness to use appropriate financial products (Roos, 2008; Zhu & Meeks, 1994). Willingness and ability to consume might also interact to affect, the incidence and level of indebtedness.

Empirically, a consumer's ability to borrow may be captured by many of the same factors expected to positively affect lenders' willingness to lend, such as current and/or expected future resources and wealth. Factors, such as current income, employment and stability of employment and repayment history, can signal future capacity to repay and are employed by credit providers to evaluate creditworthiness (Godwin, 1998; Kent, Ossolinski & Willard, 2007). Resources may take the form of physical assets (e.g., real estate), financial assets (e.g., savings, bonds or securities), and human resources such as education. Unlike South Africa where even the poorest families might be homeowners, homeownership in other contexts is both an important form of investment and a major form of savings for many families (e.g., Schunk, 2007) and expected to positively influence credit ratings due to the wealth effect attached (e.g., Mulder, 2006; Searle, Smith, & Cook, 2009).

Holding financial assets such as savings and insurance may suggest that the individual has access to financial institutions and might signal the individual's financial sophistication

(Beck, Demirgüç-Kunt, & Peria, 2008). Access to financial institutions helps to forge mutually beneficial relationships with credit providers and may directly affect a consumer's ability to participate in the credit market. Access to financial institutions might also increase a consumer's knowledge and awareness of the financial instruments on offer and might increase the probability of demanding such products if the rewards outweigh the risks involved. Financially sophisticated consumers are also expected to face lower credit constraints both because lenders will be more willing to lend to them and because they are likely to shop around to find the easier deals.

A household's past repayment performance (credit history) affects current ability to consume (Pennington-Cross, 2003; Stegman & Faris, 2005). Poor past repayment performance will have a negative effect on credit qualification and therefore a reduction in the probability of participation in the credit market as a natural consequence of credit rationing (Avery, Calem & Canner, 2004; Schwarz, 2011).

Alternatively, households' demand for credit can be affected by a combination of shocks to income and expenditure and its position in the life cycle. The life cycle model suggests that individuals adjust their spending in terms of their anticipated lifetime earnings. Thus when current resources temporarily fall short of required expenditure, households will bridge the deficit by borrowing (Bertola, Disney & Grant, 2006; Bertola & Hochguertel, 2007). A young working household may be forced to borrow due to the demands of building a family, while married consumers might have more consumption needs compared to unmarried ones. Demographic characteristics such as age and marital status and other life-cycle events such as childbirth or increase in household size are therefore important determinants of participation in the credit market. Additionally, adverse shocks that negatively affect household income and/or increase household expenditure (e.g, sudden joblessness, illness) will be expected to increase the demand for debt as households attempt to mitigate the effects of these events (i.e., smooth income) (Sullivan, 2008; Krueger & Perri, 2009; Lusardi, Schneider & Tufano, 2010) and the probability of participation in the consumer debt market – at least in the transitory period before the credit ratings deteriorate.

Household panel studies have become more influential in studying household consumption behaviour. Most empirical studies using household panel data on participation in consumer debt and its distribution among different categories of households have, however, focused on North America and Europe. Del-Rio and Young (2005) and May and Tudela (2005) use the British Household Panel Survey (BHPS) while Lee, Lown and Sharpe (2007) and Brown and Taylor (2008) employed the US Health and Retirement Study (HRS) and the US Panel Study of Income Dynamics (PSID) respectively. Magri (2007) used the Italian Survey of Household Income and Wealth (SHIW) while Keese (2009) makes use of the German Socio-economic Panel Study (GSEP). Such works have analysed characteristics that may be pertinent to households or individuals holding a certain amount of debt, demanding a loan and, or being rationed by lenders. In these studies, consumers' demographic and socio-economic factors have been found to affect both the incidence and level of consumer indebtedness. Other factors, including attitudes and expectations (that may not be visible to lenders at the time of application), have also been found to be influential in decisions to use consumer debt including the social pressures to consume. It needs to be noted, however, that in most of these studies the caveat has been the inability to find evidence of actual attempts to apply for debt and rejection of applications from the survey data. Some consumers may not participate in the debt market just because they did not need to do so whilst others do not participate because their applications were actually denied.

For British households, Del-Rio and Young (2005) identified income as being a key positive determinant of unsecured borrowing. Because a consumer's income is visible to the lender at the time of the credit application, it is supposed to exert a greater influence on lenders' decisions and that positive income may positively influence consumers' willingness to apply for credit. May and Tudela (2005) found that households that saved regularly were more likely to have debt, perhaps because they were associated with a significantly lower probability of debt payment problems and therefore lenders were more willing to lend to them as well. Among Italian households Magri (2007) found income and net wealth to be positively related to the probability of demanding a loan and negatively related to the probability of being rationed by credit providers. Holding consumer or mortgage debt in old

age in the United States was the subject of investigation by Lee et al. (2007) who found that the probability of holding both types of debt increased with the size of the household (as a result of the extra demands that come with increasing family size), being employed and being at a higher educational level (as these two factors increase a lender's trust in the applicant's ability to repay). The determinants of holding debt and of the size of debt among US households was the subject of a work by Brown and Taylor (2008) who discovered that the probability of holding debt increased with income (ability to borrow) and household size (consumption needs). They also found a combination of larger debts and higher levels of financial assets in households where the household head was employed, which also suggests their ability to borrow.

For households in Germany Keese (2009) found that while adverse shocks affecting household income and expenditure (such as increase in household size, sudden job loss, illness) have a positive effect on the demand for credit, such shocks have a negative effect on households' debt sustainability. Contrarily, Bridges and Disney (2004) argue that for such households, access to further credit might be curtailed by lenders (e.g. cancelling of credit cards) and a possible response to this might be switching to new lenders, although credit scoring will limit this strategy if there is evidence of past delinquencies. According to the Canadian Financial Capability Survey (CFCS), Canadian homeowners were more likely to be indebted and debt participation was higher among middle- to higher-income households. Younger people and parents with children at home were more likely to hold debt. Similarly, married people with children were more likely to have consumer debt compared to unmarried people. They were also more likely to have higher levels of debt perhaps due to the higher demands on their resources (Chawla & Uppal, 2012).

Similar participation pattern were observed even in households in countries outside the financially developed core, a study by Petrides and Karagrigoriou (2008) used the Cyprus Survey of Consumer Finances and found that the age, employment status and educational level of the household head, a positive attitude towards debt, and a combination of age and income were robust determinants of holding both secured and unsecured debt in Cyprus.

The rationale for reviewing this comparative literature is to test whether South African households and credit market behaved similarly or differently, given the reports of irregular credit activity. The empirical studies reviewed above seem to concur that, in practice, participation in the credit market in diverse countries is influenced by attempts to solve the respective optimisation problems of households subject to the available constraints, notably income. This supports the relevance of both the life-cycle theory and the ability to consume arguments.

More specifically, the relevance of this comparative literature to this present study can be seen on four levels. First, a number of debtor problems similar to those identified in South Africa during the credit law review had been reported in all of these countries at some stage. Second, as a response to the observed problems in the credit market and credit law, South Africa implemented legislation (the NCA) which has many similar features to credit legislations in these other countries, something that might suggest that conditions in credit markets across countries might have important similarities. Third, with regards to the ‘reference group’ idea, Cynamon and Fazzari (2008) note that the reference group idea is becoming increasingly important to economists as they begin to consider the influence of societal factors on economic decisions. As such, consumers in North America and Europe are very important social groups against which South African consumers continually compare themselves,¹⁰⁰ a phenomenon that has been fuelled in part by the mass media and the marketing trends of consumer goods including credit itself. South African firms constantly compare or benchmark themselves against those in North America and Europe and the same has happened with the credit legislation as well. Fourth, given limited previous research on South African households, this study has had to use experiences of household use of debt from other countries where similar studies have been conducted, and therefore what is known about the relationships between the variables to be used in the analysis has had to be informed by these literatures.

¹⁰⁰ With reference to the ‘Reference Groups’ idea, consumers use others as a source of information for arriving at and evaluating one’s beliefs about the world (Cynamon & Fazzari, 2008:4).

This study uses data from the Cape Area Panel Study. It will contribute to the literature by examining the socio-economic factors that influence the probability of holding consumer debt in an “under regulated market” to determine whether consumer debtors are more likely to be found in certain types of households than other – even in such markets. The study provides a snapshot of socio-economic patterns of credit activity within South Africa during a specific period (between 2002 and 2006) by testing and validating various variables drawn from existing literature as potential determinants of South African households’ participation in the consumer credit market. Any interest in the topic is further amplified by the recent reforms to the country’s consumer credit law which were (to a larger extent) in response to accusations of widespread reckless lending. In essence, this chapter tests whether this assumption holds or whether the ability to borrow had a greater influence on the distribution of consumer debt use in which case the assumption of reckless lending might be invalidated. All things being equal, if the proxies for ability to borrow (e.g., income) are not important or are negatively correlated with participation and poor past payment performance is positively correlated with participation, then reckless lending can be assumed.

It is assumed that consumer debtors in an under regulated market are more likely to be found in certain households than others – just as would be expected in a well regulated market (as in the literature analysed). The following tentative hypotheses are, therefore, investigated.

In the first instance, even in under regulated markets, households are more likely to use consumer debt because they have the ‘ability to borrow’ – given their characteristics. Zhu and Meeks (1994) posit that the ability to consume lowers borrowing constraints on households and may sometimes increase their willingness to borrow. In a regression model of consumer debt, the coefficients for per capita income, homeownership, financial assets and subjective financial wellbeing (positive conviction of financial wellbeing) are then likely to be positive.

Second, it is hypothesised that even under-regulated credit markets will exhibit a micro-economic objective (shock-absorption) such that families experiencing budgetary pressures will use the consumer credit market to relieve this pressure. Therefore, increasing demands on family resources will increase the likelihood of holding consumer debt. According to

Bertola and Hochguertel (2007) the demand for credit is derived from the deviation between current resources (budget constraint) and expenditures. In a model of consumer debt, the coefficients for increase in expenditure, increase in family size, income being less than the required expenditure, and having dependent children, are expected to be positive. Also, since a household's credit history is an important indicator of risk, current credit qualification is dependent on past payment performance (Pennington-Cross, 2003; Cohen-Cole, 2011) – and this will apply even in an under-regulated market. In a model of consumer debt, the coefficient for past delinquencies is therefore expected to be negative.

This chapter will proceed with a brief description of the CAPS and a reference to the variables of interest; a preliminary analysis of the debt patterns; results of a simple econometric analysis of the determinants consumer debt; and a presentation of results which are followed by concluding remarks.

3.2 Survey and data

3.2.1 The Cape Area Panel Study (CAPS)

The Cape Area Panel Study (CAPS) is a longitudinal study of the lives of youths and young adults in metropolitan Cape Town, South Africa. This survey primarily focuses on these young people as they transition from school to work to family formation and other outcomes including health, sexual health and intergenerational support systems as such, the CAPS survey was not a household panel study (but a panel of young adults living initially in the sampled households). Because of this, it might not be the most ideal survey for this kind of study, however, it was (at the time) the best available source of longitudinal data.

However, the data were found to be useful because, in addition to following the lives of the young adults, the survey was able to collect information on the entire households wherein lived these young adults. This household-level information was collect in each wave using the household questionnaire. The current study utilized this information since it is concerned with the situation of the entire household (as opposed to individuals).¹⁰¹ Even though the

¹⁰¹ The survey questions were not specific to any member of the household as the questionnaire only asked if 'any' member of the household was experiencing the situation of interest without seeking to identify the person experiencing that situation. Also, the head of the household is not defined by the questionnaire. The respondent

young adults in these households may have been affected by non-random attrition which almost certainly affected disproportionately the older and higher-earning young people who might be expected to live in rising income households, this sort of attrition is not detrimental to this study as the study is concerned with the situation of the 'entire household' and not of the individual 'young adults'. As long as the household in the survey continues to exist, such movements in and out of the household will actually contribute to the study specifically with regards to the effects of changing household size on the dependent variable.

The CAPS began in 2002 as a collaborative project of the Population Studies Center in the Institute for Social Research at the University of Michigan and the Centre for Social Science Research at the University of Cape Town. The project was primarily funded by the U.S. National Institute of Child Health and Human Development, with additional funding provided by the Office of AIDS Research, the Fogarty International Center, and the National Institute of Aging, and by grants from the Andrew W. Mellon Foundation to the University of Michigan and the University of Cape Town.

The first wave of the study was conducted in 2002 among approximately 5250 households and 4750 young adults between ages 14 and 22. The second wave was conducted in 2003 and 2004; Wave 3 in 2005; Wave 4 in 2006; and the latest, Wave 5, in 2009. The CAPS sample design was based on the 1996 census Enumeration Areas (EA) and employed a two-stage stratified sampling technique. The main sample, using appropriate weights, comprised a representative sample of households as well as of the non-institutionalised young adult population aged 14-22 (in 2002) in metropolitan Cape Town. This should ensure adequate representation of broadly distributed characteristics within households and among young adults (Lam *et al.*, 2008:8).

In addition to individual questionnaires, a household questionnaire was also administered in Wave 1, Wave 3 and Wave 4 and answered by a household member over the age of 18 who was most knowledgeable about everyone in the household. The realised sample was 5255

subjectively identifies the household head without any objective qualifications, as has been suggested by Budlender (2003).

households for Wave 1, 2549 households for Wave 3 and 3312 households for Wave 4. The household questionnaire collected information on household income, expenditure, and debt, adverse shocks as well as other household characteristics. This study utilised the information contained in Wave 1 (2002), Wave 3 (2005) and Wave 4 (2006) household files.

3.2.2 Measurement of variables

This section provides a brief reference to the main variables used in the analysis of the determinants of consumer debt participation. In a context like South Africa where households (as noted earlier) have a tendency to be porous and/or fluid and where resources are not always shared equally even the same household, an individual would be a better unit of analysis however, data limitations made this impossible for the current analysis. The household was the unit of analysis mainly because information on the main variables of interest was collected only at the household level while the information collected at the individual level was restricted to within a specific age group (young adults).¹⁰² Only those households interviewed in Wave 1 and successfully re-interviewed in Waves 3 and 4 are included in this analysis (N = 2549). The intention in this regard is to avoid non-random attrition which might lead to biased interpretation of results. Secondly, since this is not a pure panel of households, but rather households wherein live the young people targeted by the survey, the households interviewed in all the three waves represent a sufficiently large proportion of all households and the findings are likely to apply to the general population.

Table 1 provides the description of the variables used in the analysis, their mean values and the expected signs on their coefficients. Household participation in the consumer credit market is measured in terms of incidence (the proportion of households with consumer debt versus those without consumer debt). Respondents were asked in the questionnaire if anyone in the household was buying anything on credit in 2006, including hire purchase, store cards, credit cards, charge cards or lay-buy, and the respondent was supposed to answer ‘Yes’ or ‘No’. If a respondent answered ‘Yes’ then, the household was considered to be participating

¹⁰² In 2002, only young people between the ages of 14 and 22 were interviewed at the individual level and these were targeted for the subsequent waves in 2006, at which stage they were between the ages 18 and 26. For the purpose of this study, such parameters could not be useful as only a very small fraction of that age-group is expected to be credit active.

in consumer debt ('Yes' = 1, 'No' = 0). The one weakness in this question, however, is that only a limited number of credit types are mentioned. Such crucial instruments as cash loans and informal loans are not mentioned, and it is therefore possible that the respondent might have not considered them when responding to the question which might result in underreporting the incidence of indebtedness. It is, nevertheless, assumed that the respondents understood the question to refer to a sufficiently wide range of consumer debt.

Homeownership was used as a crude measure of family stability (with a value of 1 if the family's primary residence was owned by someone who lived in the household in 2006 and 0 if the residence was rented or other). Household per capita income quintiles were derived from a continuous variable of per capita income in 2005. For the subjective variable (financial wellbeing), a respondent was asked if he/she considered his/her 2006 financial situation to be better than it was in 2005 (1 = 'better', 0 if the situation was the same or worse). Having a bank account and life insurance are dummy variables (1 if anyone in the household had the instrument, 0 otherwise).

The measures of household consumption needs and shocks were all dummy variables: whether household expenditure increased between 2005 and 2006; whether household size increased between 2002 and 2005, and whether 2005 income was less than 2005 expenditure ($\text{Income} < \text{Expenditure}$). A self-reported variable representing random adverse shocks (negative events) was also included. A household faced a random shock if it reported experiencing any one of the negative events listed, including death, sickness, loss of a major income source, separation or divorce, etcetera (1 if at least one of the events happened, 0 if none reported).

Table 1. Variable definition, sample mean values and expected signs

Variable	Mean	Description
Debt	.50	Dummy: (1/0) if someone in the household has a consumer debt in 2006
Measures of household ability to borrow (+)		
Homeownership	.74	Dummy: (1/0) if the family's primary residence is owned by a member of the household in 2006 (+)
Per capita income	N/a	Quintiles of per capita income in 2005: (- at the lower quintiles, + at the upper quintiles)
Bank account	.78	Dummy: (1/0) if household has a bank account (+)
Life insurance	.29	Dummy: (1/0) if household has a life insurance policy (+)
Financial wellbeing	.33	Dummy: (1/0) if the 2006 financial situation is better than that of 2005, - self reported (+)
Measures of consumption needs (+)		
Expenditure▲	.66	Dummy: (1/0) if 2006 expenditure is greater than 2005 expenditure (+)
Family size▲	.55	Dummy: (1/0) if 2005 household size is greater than that of 2002 (+)
Income<expenditure	.15	Dummy: (1/0) if 2005 income is less than 2005 expenditure (+)
Negative events	.19	Dummy: (1/0) if household faced at least one of the negative events listed (e.g., death, sickness, divorce, unemployment etc.) in 2005.
Dependents	.66	Dummy: (1/0) if household had children younger than 18 years old in 2006 (+)
Age	50	Continuous: refers to the age of the household head (between 21 and 82) (+)
Married	.54	Dummy: (1/0) if household head is married (+)
Credit history (-)		
Delinquent	.22	Dummy: (1/0) if household failed to pay debts as scheduled in 2002 (-)

Another proxy for household consumption needs was the number of dependents in the household. This is a dummy variable equal to 1 if there were dependent children in the family (less than 18 years old), 0 if all family members were 18 years old and above. The variable referring to a household's credit history (delinquent) is a dummy variable (1 if a household failed to pay consumer debt as schedule in 2002, and 0 if all consumer debt was paid as scheduled).

Age and marital status of the household head are also related to household consumption patterns - in relation to the life-cycle theory (e.g., Godwin, 1998; Kim & Delaney, 2001). The household head's age (in 2006) is a continuous variable restricted to between 21 and 82 year of age (1st and 99th percentiles), while marital status is a dummy variable (1 if married, 0 otherwise).

In relation to the stated hypotheses, participation in the consumer credit market is influenced by the household's ability to borrow and the household's consumption needs. For this study, ability to borrow is measured using homeownership in 2006, per capita income quintiles in 2005; having a bank accounts or an insurance policy in 2006 and the subjective perception of an improvement in the financial situation between 2005 and 2006. Everything else being equal, positive values of these variables should indicate positive household creditworthiness and therefore an increased likelihood of participation in the consumer credit market in 2006. The likelihood of participation and non-participation are symmetrical: that is, the same factors that influence participation in the credit market will affect the likelihood of non-participation in the opposite direction.

With regards to household consumption needs, increase in consumption expenditure between 2005 and 2006; increase in family size between 2002 and 2005 and the households' general expenditure being higher than income in 2005 may have forced households to borrow and, therefore, the odds of holding a consumer debt for these households was expected to be higher in 2006 *ceteris paribus*. Also households which experienced unanticipated negative events in 2005 may have been forced to borrow, possibly to deal with the financial demands that may have resulted from such events while households with dependent children would be expected to face higher expenditure needs that may necessitate borrowing. It should thus follow, if all else is equal, that households which faced negative events in 2005 and those with dependent children in 2006 will have an increased likelihood of being in debt in 2006.

Poor payment performance affects creditworthiness negatively and therefore reduces future access to credit. Thus households that did not pay their debts as scheduled in 2002 may have suffered from credit discrimination between 2002 and 2006 and were less likely to hold debt by the time of 2006 survey *ceteris paribus*.

These were the best available variables to test whether: households were borrowing because they had the means to satisfy lenders' due diligences; lenders were making rational lending choices (by not lending to those with the least likelihood to repay) or; whether the decision to borrow was more likely to be forced on households by financial pressures.

3.3 Preliminary analysis

As indicated in Chapter 1, the two broad classifications of household debt are consumer debt (acquired for consumption purposes as opposed to business or income-generating purposes and includes hire purchase, store cards, credit cards, charge cards, micro-loans, personal vehicle finance and informal loans from friends and relatives) and housing debt (including mortgages for investment in real estate or purchase of family residence, as well as loans for home improvement such as enlargement of a family home). Only loans or credit acquired for consumption purposes were considered for this analysis.

Table 2 provides the summary statistics for the variables of interest, including chi-square measures of association between the household characteristics and the binary dependent variable, ‘debt’. The distribution of characteristics among households with, and those without, consumer debt is presented as mean values, whilst bivariate Spearman’s rank correlation coefficients are also presented for the measures of the strength of the relationship between the dependent variable and the individual independent variables (significant at the 5 per cent level). The CAPS data on this panel suggest that household participation in consumer debt declined between 2002 and 2006, albeit very minimally (by only 2 per cent). The portion of households with any type of consumer debt decreased from 52 per cent in 2002, to 51 per cent in 2005, and 50 per cent in 2006.

Indebted households reported spending an average of R570 on debt repayment in 2005 and this declined to R446 in 2006. Reported debt repayment as a share of total expenditure also decreased from 18 per cent to 12 per cent (albeit with large standard deviations, of 13 per cent and 12 per cent in 2005 and 2006 respectively).

Homeownership, financial assets (bank account and life insurance) and subjective financial wellbeing – i.e., the proxies for a household’s ability to borrow – were found to be the significant correlates of holding consumer debt in 2006 but homeownership did not have the expected effect as a negative correlation was observed. With regards to the measures of household consumption needs, significant differences between households with consumer debt and those without consumer debt were also observed with regards to increase in family

size; increase in expenditure, negative events, as well as the marital status and age of the household head.

Table 2. Summary statistics of bivariate relationships for households with and without debt (correlation coefficients and their P-values)

Variables	With debt	Without debt		
	Mean	Mean	Corr	P*
Ability to borrow				
Homeownership	.73	.80	-.057	.004
Per capita income (2005)	R1478	R1404		
Quintile 1	.20	.20	-.001	.944
Quintile 2	.19	.21	-.030	.130
Quintile 3	.20	.20	-.008	.676
Quintile 4	.21	.20	.023	.141
Quintile 5	.20	.19	.016	.409
Bank account	.91	.64	.327	.000
Life insurance	.42	.15	.291	.000
Financial wellbeing	.45	.19	.275	.000
Consumption needs				
Family size▲	.58	.51	.049	.015
Expenditure▲	.76	.57	.198	.000
Income<Expenditure	.15	.15	-.002	.907
Dependents	.68	.65	.026	.137
Negative events	.18	.21	-.042	.033
Married head	.58	.51	.064	.001
Age of head	.51	.49	.077	.000
Credit history				
Delinquent	.22	.23	-.014	.405

Notes: Corr refers to bivariate correlation coefficients. P* Refers to chi-square test for significance

Although no significant differences were observed between the distribution of indebted and non-indebted households between per capita income quintiles, the descriptive statistics hint that the chances of holding consumer debt increase as per capita income increases. Sixty-eight per cent of households with dependent children had consumer debt while 65 per cent were not in debt and, while intuitive, these differences were not statistically significant. The negative relationship between delinquency and holding consumer debt is also intuitive although insignificant.

Overall, the descriptive statistics presented in Table 2 above provide mixed evidence for both capacity-to-borrow and life-cycle/shock effects on consumer debt. Homeowners were less likely to hold consumer debt as opposed to renters, while households which possessed financial assets and those who believed their financial situation to be better in 2006 were

more likely to borrow as they had the ability to do so. Households' participation in the consumer credit market increased with increasing demands on family resources, as can be observed from the relationship between increase in family size and increase in expenditure.

These descriptive statistics present the first signs of association between households' participation in the consumer credit market and the variables relating to households' ability to borrow, consumption needs, and credit history. Only two significant relationships (that of homeownership and random negative events which were negatively correlated with participation) did not have the expected effects. With regards to the proxies for ability to borrow, only one variable (financial assets) that could be visible to lenders at the time of applying for debt was positively related to participation. Since income and past payment performance (major variables in lender risk assessment exercises) were insignificantly related to participation in the credit market, the assumption of reckless lending cannot be validated nor disproved. The preliminary results for increase in family size, increase in family expenditure, marital status and age, however, are consistent with the life-cycle theory and tell a story of households using consumer debt to smooth income in the face of an income strain. And in the case of age, social pressures to consume might also be inferred.

3.4 Econometric analysis

In order to analyse the determinants of participation in the consumer debt market, a multivariate binary dependent variable model is used where the dependent variable may take on only two values (having consumer debt = 1 or not having consumer debt = 0). The households are expected to differ in their statuses in terms of ability to consume, which is characterised by the size of the income per capita, ownership of physical and financial assets, and the subjective measure of financial wellbeing. Their consumption needs should also differ. These are informed by changes in expenditure; changes in family size; income relative to required expenditure; the presence of dependent children; experiences of a random negative shock; and the head's age and marital status.

The differences in socio-economic characteristics (which will play the role of explanatory variables in a logistic model) either may influence a household's demand for debt or may be

the basis for a household to be rationed by the lender, thereby affecting the probability of holding consumer debt. The econometric analysis used in this part is akin to the analyses of other societies employed by Godwin (1998); Lee et al. (2007) and Petrides and Karagrigoriou (2008).

It is worth noting beforehand that because the survey was not designed to test hypotheses about consumer debt, the model uses only the variables available in the data. This analysis would have been much stronger if more relevant variable were to be found in the data.

The logistic model employed for this analysis assumes that if Y is a stochastic variable following a binomial distribution (n, p) , p will be the probability of holding consumer debt. The model follows a standard transformation of the type:

$$\text{logit}(p) = \ln(p/(1 - p)) = \beta_0 + \beta_1 x_1 + \beta_2 x_2 + \beta_k x_k, \quad (1)$$

Where x_1 is the vector of socio-economic characteristics of a household related to the household's creditworthiness (ability to borrow), x_2 the vector of characteristics related to the household's position in the life cycle and other life events, which affects its consumption needs and x_k refers to credit history while $\beta_1, \beta_2 \dots$, are their corresponding logistic coefficients, such that, a one-unit change in the predictor will lead to a change in the logit score by β units. The probability of holding consumer debt by a household is thus given by:

$$p_1 = \frac{\exp(\beta_0 + \sum_i \beta_i x_i)}{1 + \exp(\beta_0 + \sum_i \beta_i x_i)} \quad (2)$$

The above equation guarantees that p_1 will always have a number between 0 and 1 where β_i is estimated by $\beta_i, i = 1, \dots, k$ and since p_1 is the probability that a household has a consumer debt (i.e., $Y = 1$) given the values $\mathbf{x} = (x_1, \dots, x_k)$, then $1 - p_1$ is the probability that a household has no debt ($Y = 0$). The likelihood function for $Y=1$, derived from the binomial distribution under the assumption that having a consumer debt versus not having that type of debt is just a random situation in an under regulated market, is given by:

$$l(\beta) = \prod \pi(x_i)^{y_i} [1 - \pi(x_i)]^{1 - y_i} \quad (3)$$

Where $x_i = (x_{i1}, \dots, x_{ik})$ denotes the vector of the socio-economic situation of household (i) and Y_i is either 1 or 0 (whether a household holds the type of debt in question or not).

3.5 Results

The results of the logistic regression analysis appear in Table 3, and a predictor is statistically significant at either $p < .01$, $p < .05$ or $p < .10$. With regard to households' ability to borrow, the results indicate that per capita income, financial assets, homeownership and subjective financial wellbeing were statistically significant in predicting the probability of holding consumer debt. In the case of household consumption needs, the resultant significant variables were: increase in household expenditure; increase in family size; having dependent children; where the household head was married and the age of the household head. Although the negative sign on its coefficient is intuitive, poor credit history (delinquent) was not statistically significant.

The findings in the first instance suggested that, even in an under-regulated market, consumer debtors are more likely to be found in certain households than others. Specifically, households at the higher level of per capita income; those who held financial assets; those with a positive perception of their financial situations; households who experienced an increase in total expenditures; those whose family sizes increased; and those with dependent children were more likely to report having consumer debt. Contrary to expectations, homeownership was negatively associated with consumer debt (as the bivariate relationship suggested). The age of household heads and their being married were positively associated with holding consumer debt. Second, both sets of factors play an important role in the probability of participating in the consumer credit market.

As can be noticed, per capita income was only significant at the fourth and fifth quintiles and a positive relationship with debt participation is observed. While insignificant, a decreasing probability of holding consumer debt is observed at the lower level of per capita income (insignificant at q1 to q3). This can be interpreted to mean that per capita income will only

matter for participation in the consumer credit market at a relatively higher level. Although households at a lower level of income might need debt to supplement their low incomes, it is possible that many of them might be either discouraged from applying for credit for fear of being rejected or are rejected when they apply. As incomes increase, household might be more confident in their abilities to borrow and will actually apply for credit, but then, the success of these applications will depend on other characteristics such as credit history.

Positive perception of financial wellbeing was also found to have a positive relationship with debt participation. This could be interpreted to mean that perhaps such households had a higher willingness to apply for debt due to their own confidence in their abilities to repay as opposed to lenders own selection criteria. The positive perception could also have resulted from other factors that might influence lenders positively (e.g., a good income).

Financial assets (i.e., bank account and insurance) were also positively associated with participation in borrowing. While these can be considered as modest buffers against shock, they also suggest accessibility to financial institutions or rather financial sophistication. Both cases can be assumed to influence confidence either of the lender in the viability of lending to a particular household, or the confidence of the household in using the credit market. Financially sophisticated consumers are presumed to have a higher willingness to make use of a variety of financial products.

Homeowners were less likely to hold consumer debt than those who were not. Other factors being constant, the odds of holding consumer debt were 36 per cent lower for homeowners than the odds for non-homeowners. The explanation for this could be that perhaps homeowners were choosing to participate in other forms of borrowing and that the resultant burdens (e.g., their mortgage repayments) were enough to deter them from borrowing for consumption. In spite of the negative relationship observed for homeownership, the results support hypothesis one. Participation in the consumer debt market was therefore being influenced by creditworthiness (other factors constant, households were using consumer debt because they had the ability to so).

Table 3. Logit regression results for consumer credit market participation

Results of the logit regression analysis for consumer credit participation		
Dependent variable: Have consumer debt = 1 No consumer debt = 0		
Independent variables	Coefficients	Odds Ratios
Per capita income 2	-0.13 (0.15)	0.88
Per capita income 3	-0.03 (0.15)	0.97
Per capita income 4	0.37** (0.15)	1.44
Per capita income 5	0.36** (0.18)	1.44
Bank account	1.08*** (0.13)	3.00
Life insurance	0.73*** (0.11)	2.10
Homeownership	-0.44*** (0.11)	0.64
Financial wellbeing	0.57*** (0.11)	2.00
Expenditure▲	0.63*** (0.12)	2.00
Family size▲	0.24** (0.10)	1.26
Income<Expenditure	0.08 (0.14)	1.08
Dependents	0.30*** (0.10)	1.34
Age	0.01* (0.00)	1.01
Married	0.24** (0.09)	1.26
Delinquent	-0.02 (0.11)	0.97
Intercept	-2.20*** (0.29)	
N	2,269	
Chi-square	330.755	
Pseudo R ²	0.127	

Note: Robust standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.10

As was expected, households with more resources faced less trouble in accessing consumer credit compared to their under-resourced counterparts. Also, such households might have been more willing to apply for credit based on their conviction that they would be able to

repay when the debt was due or based on the conviction that their applications would be not be rejected by credit providers. The opposite may also be true for those who are less creditworthy who may be discouraged from applying with the knowledge that they are less likely to qualify. This directly speaks to the importance of social perception in financial decision-making (Katona, 1975). For example, if real incomes and/or confidence in economic prosperity increase, the confidence to consume will also be expected to increase.

A generally positive relationship between a household's consumption needs (which are characterised by the household's position in the life-cycle and shocks to household income and expenditure) and participation in the consumer credit market can be observed. While holding other variables constant at their means, the predicted probability of holding consumer debt was 0.15 higher for families whose general expenditures increased between 2005 and 2006 compared with those whose expenditure declined or remained constant during the period. Households that experienced an increase in size between 2002 and 2005 had a 27 per cent increase in the odds of participating in the consumer credit market compared with those whose size did not increase during the period while the odds for households with dependent children were 35 per cent higher than the odds for families without in 2006 – holding other predictors constant.

These results should suggest that, despite the under regulation, the consumer debt market was satisfying its micro-economic objective (Bertola & Hochguertel, 2007). Households were using the consumer credit market to smooth consumption during mismatches between desired consumption and available resources and as insurance against risk. These results support the theoretical life-cycle model of consumption. Hypothesis two is also supported. The statistically significant positive relationship observed for increase in family size, increase in total expenditure, and having dependent children is intuitive and suggests that needs compel many households to borrow – as long as their credit ratings are still good. Similar results have been found using data from well regulated markets, such as Italy by Magri (2007), and in regard to the debt participation of older Americans (Lee et al., 2007).

The probability of participation in the consumer credit market increases with the age of the household head and this probability is also higher for married household heads. While statistically insignificant, the negative sign on past arrears was intuitive, since poor payment performance increases the chances of being denied credit in the future.

Generally the results of the regression analysis indicate that both the ability to borrow as based on positive resources and demands on family resources (as resulting from changes in family circumstances and shock) played some role in the distribution of the incidence of consumer debt. These results do not provide evidence of reckless credit practices although the insignificant relations between participation and the credit history and the absence of actual amounts of debts borrowed in the data makes it harder to determine whether reckless practices were involved.

3.6 Personal stories of indebtedness

In attempting to triangulate the findings from the CAPS survey, informal in-depth interviews of a guided nature were conducted with 20 individuals of varying ages between 15 March 2010 and 6 September 2010. The participants were chosen randomly from a broad cross-section of adults around greater Cape Town to elicit information regarding their experiences with the consumer debt market or the lack of it. The sampling was largely convenient – based on the willingness of the individual to spend at least 20 minutes sharing his/her experiences on indebtedness. The interviews were kept within the parameters of experiences with and attitudes towards consumer credit use and indebtedness. This meant that not all the interviewees had to be in debt themselves but had to be of a credit-active age (20+ years old). The inserts below provide a snapshot on the social realities learned from this process and these realities have gone some way in supporting the empirical findings, but have also elicited some new insights related to the social construction of needs.

With regards to débating and re-entry into debt, positive incomes and personal consumption needs (resulting from negative shocks), were found to influence indebtedness in the same direction. Variables such as finding a job and experiences of a misfortune (e.g., illness or death) were found to be influential triggers of participation in consumer debt. Poor past repayment performance and poor economic standing meant that some people found it hard to maintain their participation in the credit market. Past payment delinquencies made it hard for consumers to be accepted for new credit, while those who were unemployed or without a regular income were not favoured by credit providers. Finding a permanent job was noted as an influential positive shock which opens doors to the credit market (see insert). Doug, a 28-year-old recent graduate whose outstanding debts totalled R14, 000 (mainly for household effects and clothing), had never had to use consumer credit until he found a government job two years earlier. He explained that he had always admired the ease with which people with permanent jobs were able to borrow. For him, it felt like ‘just walking into a store and carry things home without paying for them’. Although he was aware of the costs involved, the ability to consume now and pay later (using his permanent job as collateral), far outweighed the costs.

Experiences of unanticipated shocks force consumers to borrow even when they might be debt-averse. Joan (39 years) had paid off all her debts and was planning to ‘stay debt-free’ – until she lost her mother, who had been sick for a while. Joan had spent a considerable amount of money caring for her mother during her sickness. She then had to borrow R9,000 from a micro-loan lender to cater for extra burial expenses. At the time of the interview (seven months later), her indebtedness had grown to more than R11,000 because every month she needed extra money to cover all her expenses, including the monthly installment for the initial cash loan. To do this she had borrowed smaller amounts from friends and work colleagues to cover the deficit.

I didn’t get credit until I got a permanent job. Initially I had low credit ratings and never borrowed from cash loans or stores. I borrowed small amounts from friends sparingly, paying off even before they demanded. Now that my ratings are good, stores practically beg me to take credit ... my bill is overwhelming though ... I need to stop.

Johannes (37).

Access to financial institutions as a determinant of participation in the consumer debt market was another issue that came out of these life stories. Lenders' solicitation efforts, especially with promises of rewards, affect borrowing decisions positively as noted by Gladys (32 years): 'I didn't know I qualified for a credit card until I opened another bank account with [...] bank. The rewards they promised me were too good to be true ... now I have three credit cards and I am not sure I need them really...'

A few other life stories related to situations which were more or less similar to those above. Changing lifecycle needs, demand for leisure, unforeseen shocks, were some of the situations that compelled some respondents to use debt. At least four people attributed their participation in debt to entering married life. They claimed that they got into debt for the first time when they got married or in preparation for marriage and borrowed for the extra expense that came with the responsibilities of marriage.

Expenses for leisure activities such as paying for a holiday and a lavish party were also part of the story depicting social and, possibly, cultural pressures to consume. Participants intimated that many people in their communities were falling into debt, especially during the festive season (November and December) because leisure activities are so widespread during this period. Kubus (43) explains that 'you want your family to have a good time during the festive season, here on the Flats¹⁰³ some people spare no expense as long as they can get a cash loan from a micro-lender or a friend to complement the end of year bonus'. Gladys (32) also noted that credit providers are more generous during this period as the chances of having a credit request approved are always higher. She attributed this to the credit providers' need to exploit the myopic behaviours exhibited by consumers during this period. She notes that the months following the festive season are quite stressful for many, as demands for repayment start coming in from all directions yet people have other 'inescapable day-to-day family commitments'. She considers these behaviours myopic because every year people

¹⁰³Referring to the Cape Flats area of the Greater Cape Town.

You see I've always wanted to have one of those big cellphones ... the Blackberry one, but I went to and they refused to give it to me because [I]am not permanent at my work.

seem to forget how hard it was for them to deal with the debts they accumulated the previous year.

A death in the family and loss of employment were common themes too. The lure of conspicuous consumption as an important influence for the

'willingness to borrow' was also part of the story. Stories of the desire to be trendy or blend in, especially among young people, abound. Siya (a 27-year-old part-time student) commented that most of his 'friends and former schoolmates are buying things on credit ... they have nice things, cars ... and everyone thinks, that's cute... to our generation, credit is a way of life so, I can't help myself.'

When young people aspire for a better life, they see credit as a very important tool to that end. 'We are all rushing to get jobs after school so that we can be able to qualify for credit as soon as possible. We don't know much about building credit histories, it's just about getting the credit... maybe a car loan or something... many of us don't think about buying our own houses in the foreseeable future because we know we can pay rent with our salaries in nice suburbs and credit can cater for the rest', was the observation from Anthony (23) – a fourth-year university student.

For those who were not credit active, asymmetrical effects in relation to those in debt were to be found. Poor repayment history and joblessness were part of the story. Norah (47) was not in debt although she badly needed to borrow in order to entertain her family over Easter (which was a few weeks away). She had tried to secure credit without success. Her predicament was caused by her past defaults totalling almost R4, 000. These debts had been written off almost a year before, but her credit record was not yet cleared – indicative of some of the weaknesses that persist even under the new regulatory regime. Other stories of credit market exclusion related to the poor economic standing of individuals, including not being in permanent employment (insert above) or not being employed at all.

Another important insight from the ideal types is that while some of those in debt wanted to get out of it, a few of those not in debt were desperate to get in or thought their lives would

be better if they were able to access some form of debt. Older debtors were most likely to say they wanted to get out of debt and younger debtors held more favourable attitudes towards borrowing. Older, more so than younger, people were also most likely to say that it was possible to have a happy family life without having to borrow. To many younger people, access to credit was the precursor to a happy family life.

In conclusion, the life stories of people's experiences with credit market participation support to a larger degree the result of the analysis of the CAPS data. Creditworthiness (ability to borrow) was found to be an important determinant of access to consumer debt. Employment and good repayment performance were rated highly as factors influencing access to credit. Most stories were related to the effect of consumption need, as many people were pushed into indebtedness by changing demands on their resources (especially abrupt and unanticipated), including pure economic shocks. The attitudes of younger people towards borrowing were found to be consistent with the life-cycle theory of consumptions. Equally important, these life stories also provided evidence of the social construction of consumer needs – which could not be tested in the CAPS data. It is highlighted that social and indeed cultural aspects are shaping consumption needs of many South Africans. For instance, when someone gets a good job, they are under some kind of pressure to consume more.

3.7 Conclusion

The social-economic determinants of participation in the consumer debt market were examined in this chapter through the lens of the Cape Area Panel Study. A model, primarily based on the life-cycle theory of consumption (Ando & Modigliani, 1963) and ability to consume (Katona, 1960; 1975) as well as random shock, was tested for the odds of holding consumer debt and not holding consumer debt in 2006. The variables applied for this analysis relate to household characteristics identified in available literature (mainly from North America and Europe) as influential in the lenders' decisions to grant credit and the borrower's decision to make use of the credit market. Essentially, the analysis intended to verify whether South African consumer debtors (at the time when the market was under regulated) lived in

certain households instead of others as was observed in North America and European – where the credit markets were appropriately regulated.

There were marked differences between the distributions of household characteristics which served as the independent variables in the estimation of the determinants of consumer debt participation. The study hypothesised that even in the absence of appropriate market regulations, lenders will guard against default losses and the credit market will still satisfy its micro-economic objectives. As such, at least two factors will determine households' participation in the credit market: consumers supposed capacity to repay and the desire to satisfy consumption needs. *Ceteris paribus*, households were more likely to participate in the consumer debt market if they had higher per capita income; had access to financial institutions; and held a positive conviction of their financial wellbeing. This suggests that they had the ability to borrow and therefore lenders were more willing to lend to them than those lacking these qualities. In addition, other factors being constant, households had higher odds of participating in the credit market if they experienced an increase in expenditure; increase in family size; had dependent children and/or if the household head was married. This suggested that their consumption needs were affected by these factors.

Households without debt, conversely, were either denied debt (because they could not afford it) or may have chosen not to apply — most likely because they were afraid of being turned down and (especially as the ideal types suggested) less likely because they were content with the resources at their disposal. Homeowners were less likely to have consumer debt, a fact which cannot be construed as resulting from the natural consequences of rationing but one may assume it to be an aversion to consumer debt due to, on average, their relatively advanced age which might see them entertain less favourable attitudes towards consumptive borrowing.

The evidence seems to suggest that participation in the consumer credit market is thus both a function of fulfilling supply conditions (creditworthiness) and/or compelling demands on family income including mitigating the effects of unanticipated shocks to income. However, in comparison with the life stories of people's experiences with debt, it becomes clear that

the factors affecting the incidence of indebtedness might be more complex than hypothesised, – lending and borrowing decisions seem to be more than the aggregation of the lender's and/or consumer's individual decisions. Social and cultural factors not only shape consumers' needs, but also their acceptance and use of credit. For instance, having a proper job or regular income is associated with inflated needs – needs that might be inflated beyond the individual's actual income constraint. In some cases borrowing decisions are influenced by the individual's social environment. Due to data limitations, this contention could not be tested empirically.

Nonetheless, the regression results seem to concur partly with previous empirical evidence from other countries which stress the relevance of socio-economic conditions in influencing consumer debt participation (Beer & Schürz, 2007; Brown & Taylor, 2008; Magri, 2007; May & Tudela, 2005). This indicates that, all other factors being equal, the debt supply conditions of South African households (during the period of interest) were not much different from those of other countries studied. In spite of the wide-ranging reports of irregular lending practices during the period of interest, these findings generally portray lending and borrowing practices that were following an intuitive trajectory in that credit was most likely to go to consumers who were most likely to afford it whilst some consumers were simply smoothing consumption upon a background of shortfalls in their resources (i.e., households used credit as a substitute for income support in times of risk).

As noted earlier, the period studied is of historical importance in terms of the South African credit regulatory regimes. The current regulatory regime (the NCA) was passed due to the widely reported irresponsible lending and borrowing practices during this period. Notwithstanding this – and while these arguments might be true to an extent – the findings in relation to 'ability to borrow' seem to be in conflict with these arguments as it suggests that consumer debt participation was more distributed among those more likely to pay and less among the vulnerable groups. This should suggest that if consumers should experience debt problems, the reasons for this would be more complex than the mere fact that lenders and/or consumers behaved reckless.

It is worth noting also that behaviours in an under-regulated market can be very complex and unpredictable. A multitude of factors might be responsible for the consumption patterns of households including hidden characteristics on both sides of the market. Such issues would make the data inadequate. Such issues make it impossible to confirm these assumptions with certainty. It is especially not possible to know which types of credit the different types of households used, or whether the households without debt were indeed not creditworthy or they simply did not apply for fear of being turned down.

In terms of policy, these findings can capture factors that affect the level of indebtedness, and the probable reasons for consumers to descend into the more serious problem of over-indebtedness. These results can also explain the scanty diffusion of debt among poorer households who might need it even more than their affluent counterparts – who enjoy easier access. In addition, the relationship between consumption needs and participation in the credit market underpins the argument for growing a strong consumer credit market that can effectively absorb household shocks. In this regard, the credit market can continue to play an important role as a market-provided safety net for the vulnerable as long as they exercise moderation in its use and are given efficient legal safeguards.

Conversely, the importance of credit in providing consumption insurance should not be overstated, given the natural tendency of individuals to over-indulge. Indeed, one of the key risks associated with unsecured debt in general is that it is increasingly used by high-risk borrowers in their efforts to make ends meet. Commentators have raised two key concerns: the first one being whether households fully appreciate the costs and implications of using unsecured debt (some life stories suggested they did not), the second being whether the increased availability of unsecured credit has encouraged widespread over-indebtedness, particularly of middle-income households who enjoy easier access. These concerns endure even in the well regulated markets of North America and Europe where over-indebtedness has become the bane of the middle class due to their unlimited access to credit and the demands of the staples of middle-class life. As such, regulating credit access might not be enough and should not be over-emphasised – as the profit motive will keep lending decisions

intuitive – but consumers need to be educated about the inherent risks of debt use. That way they may be able to resist the lure of easy credit.

Household access to, and use of credit is a topic that needs further exploration. The findings of this analysis can be compared with households' credit participation using newer data to adjust for the effect of the recent regulatory reforms. This should help resolve the query on whether the relationships found in this study hold up with current credit market practices. A comparison of credit use by low-income households with that of middle –and-high-income households based on the size of debt held can help bring to the fore the interrelationship between credit use and household income. Replicating this study by introducing more attitudinal, demographic and economic variables may be more meaningful in distinguishing between why households use or do not use credit. This being said, it is possible that some households do not use credit because they simply do not want or need it, while others cannot use credit because, given their characteristics, they are shut out of the credit system.

The next chapter attempts to test whether the factors related to ability to borrow and consumption needs also affect the level of indebtedness in the same way they have been found to affect the incidence of consumer debt participation.

Chapter 4: The level of indebtedness

Abstract

By all indicators, consumer debt has become a defining feature of South African family life. With a growing middle class, such fundamental aspirations as going to college, buying a bigger car, having another child, require more borrowing. High levels of indebtedness are making consumers more financially vulnerable as even the slightest swings in income may push them over the edge, thereby forcing them to abandon their financial obligations. Using the National Income Dynamics Study (NIDS) data, this chapter examines the factors that affect the level of consumer indebtedness. The results indicate that the size of consumer debt held is influenced by income and educational attainment (resources that positively influence lenders' decision to lend), marital status and the number of commitments. In addition, while borrowing was not concentrated among the vulnerable consumers (such as the low-income, less-educated or disabled), this group of consumers faced the heaviest debt-service burdens. This suggests that although the biggest amount of debt was held by consumers who were more likely to repay, there are pockets of vulnerable consumers who are less likely to manage their indebtedness. This raises further questions as to their capacity to sustain future consumption and might have implications for welfare and financial stability. A positive relationship was also revealed between the size of the outstanding debt and the debt-service burden, which might suggest the need to restrict consumer credit access especially among those with limited means.

Keywords: Consumer credit; Debt-service burden; Indebtedness; NIDS; Outstanding debt

4.1 Introduction

It has been noted in the last chapter that participation in the consumer credit market (i.e., the incidence of indebtedness) can be explained by household creditworthiness and household consumption needs and that, all factors constant, the case study population were borrowing predictably in the sense that those who held debt either had the physical ability to borrow or they might have been forced by legitimate demands on their resources. This chapter investigates whether the amount of consumer debt held might also be affected by the same factors found to affect the incidence of indebtedness.

The level of indebtedness can give insight as to the financial health of the household sector and its ability to sustain borrowing by meeting their financial commitments. The strength or weakness of household finances has a significant effect on overall economic well-being and financial stability, because the household sector is such an important component of any modern or modernising economy. While prudent borrowing can enhance household and national welfare, excessive debt can make households more vulnerable to shocks and increase risks to the financial system, as the recent world financial crisis has shown. Analysing the factors associated with the level of household indebtedness is, thus, of interest and relevance to the conduct of the South African socio-economic policy and credit legislation.

In the present chapter, the level of consumer indebtedness is analysed in terms of (1) the amount of total outstanding consumer debt owed and (2) the size of the required monthly consumer debt repayment to monthly income – which, is the narrowest measure of the consumer's debt-burden (e.g., Maki, 2000). As in the previous chapter, two sets of variables were chosen as possible determinants of the level of consumer indebtedness: factors that represent a consumer's ability to borrow and proxies for consumption needs.

As is the case with the incidence of indebtedness, a number of previous studies (from North America and Europe) also found the level of consumer indebtedness to be related to a number of variables that signal consumption need such that negative income and other circumstance that put pressure on available resource will push consumers to the limits of their credit accessibility. This may translate into a higher outstanding debt held or a heavier debt-burden (e.g., Webley & Nyhus, 2001; Kim & De Vaney, 2001; Bertola & Hochguertel, 2005). Other studies (e.g., Zhu & Meeks, 1994; Roos, 2006; Petrides & Karagrigoriou, 2008) have found

that a consumer's ability to borrow (i.e., creditworthiness) determines how much they are able to borrow. Based on the viability of the consumer's resources, lenders will be willing to lend as long as consumers stay within their credit limits which often correspond to the size of commitments relative to available and expected resources.

In addition, some studies show that future expectations affect the level of current consumption. If consumers are confident in the stability or growth of future incomes, they are more likely to borrow more (Brown, Garino, Taylor & Price, 2007). Consumers with positive expectations of future income might increase their consumption levels with the anticipation that future repayments will not be such a burden. Those with negative future outlooks may choose to reduce consumption levels as a way of buffering themselves against possible hard times even when they still have the ability to consume. The consumer debt-service ratio and the total outstanding are thus affected by (1) consumption needs (2) ability to borrow and (3) financial expectations. As in the last chapter, the variables used in the current analysis to proxy for these three factors are chosen from existing literature from other countries where household indebtedness has been studied using consumer-level survey data.

4.1.1 Consumption needs

As noted in Chapter 1, a consumer's stage in the life cycle will affect consumption needs. Consumption needs relate to the *need* to finance larger amounts of life-cycle living expenses upon a background of unstable and or inadequate incomes which can be reflected in the increased desire to borrow (thereby affecting the size of debt in absolute terms) and sometime, reduced ability to meet all commitments as they fall due (which might affect the debt-service ratio). Variables such as age, marital status, health status or dependence might influence the amount of consumer debt people are likely to hold.

Previous studies – in reference to the US (e.g., Dylan & Kohn, 2007) and Britain (Tudela & Young, 2005) – have found a polynomial behavior with respect to the relationship between age and the size of consumer debt held. These studies found that younger consumers are more likely to carry heavier debts both in absolute terms and in terms of the debt service relative to income than older consumers. In this respect, the size of debt held will increase with age and then peak at a certain age (usually around 40 to 45), then start to decline. Kempson (2002) also found that, not only British consumers aged in their twenties or early thirties tended to have the highest debt-income ratios, they were also most likely to have the highest number of credit commitments. This polynomial relationship can be explained by the changes in consumption

needs as younger consumers make initial attempts at family formation – including asset accumulation – against a background of fledgling yet volatile incomes at a time when consumers are still new entrants in the job market. However, at a certain age – as the incomes stabilise and bequest motives take over – some consumers might slow down on credit consumption or retire the debt altogether which, will correspond with the fall in the level of indebtedness. Marital status and the existence of children are also important factors in explaining who carries what level of debt. In fact, Kirchler, Hoelzl, and Kamleitner (2008) note that not only do children spend money themselves, they also directly influence their parents' decisions. Magri's (2007) study of households in Italy showed that marriage life and having children carry extra financial commitments which might explain the higher level of borrowing. Consumption needs in such households are expected to be influenced by recurrent family issues such as health care, special care and, sometimes, education needs of the children. Given such needs, a higher level of indebtedness should be expected in these households than in unmarried or childless households.

Health and disability affect consumption needs and should therefore have a bearing on the level of indebtedness. Contrasting results have emerged in the literature in this respect. The Kempson (2002) study found that individuals who were unable to work through long-term ill-health or disability used credit much less often and therefore were less likely to hold large volumes of outstanding debt. Other studies found that ill-health or disability may impinge on an individual's ability to manage debt, by reducing the capacity to repay, in particular because of a reduction in an individual's ability to work, while the extra demands associated with care (medical or otherwise) might necessitate more borrowing, thereby increasing the absolute amount of debt and the debt-service ratio (Balmer, Pleasence, Buck & Walker, 2006; Lenton & Mosley, 2008). In fact, Balmer et al. (2005) found long-term illness or disability to be the strongest predictors of debt in their study of adult consumers in England and Wales, with respondents in that category found to be more susceptible to long-term debt problems, both due to the recurrent demands of extra health care and low income.

4.1.2 Ability to borrow

Again, as noted in Chapter 1, a consumer's ability to borrow (creditworthiness) is related to the lender's trust in the viability of a consumer's current and future resources. It is this that convinces the lender that the consumer will be able to repay his/her debts as they fall due. Resources are expected to have an effect on the level of indebtedness, in that lenders are more

willing to lend to consumers with a higher value of resources or such consumers may be more willing to use credit as they are less likely to be rationed by lenders than their counterparts with lower levels of resources. Resources can take on two forms, namely economic and human resources. Economic resources relate to the consumer's income while education can proxy for human resources as well as a future economic resource. Both variables are expected to correlate positively with credit qualification and therefore a higher level of consumer debt should be expected.

According to Godwin (1998), all else being equal, ability to borrow may also affect the observed quantity of both the size of the consumer (and total) debt held for a cross-section of households, as well as any changes in the debt status over time. While Betti et al. (2007) did not find a consistent pattern with regards to the relationship between income and the size of the consumer debt held in their study of EU consumers, Kim and De Vaney (2001) found a positive relationship between income and total outstanding consumer debt balances among American credit card users. In contrast, income was negatively related to the size of the total outstanding debt in Italy by Magri (2007). Intuitively, a negative relationship between current income and the debt-to-income ratio was found in the US (Dynan & Kohn, 2007; Brown & Taylor, 2008) and in Britain by Del-Río and Young (2005).

Similar to the effects of employment-which has also been found to have a positive relationship with the level of consumer indebtedness both in the U.S (Zhu & Meeks, 1994; Brown & Taylor, 2008) and Britain (Brown & Taylor, 2008) – education can influence the consumer's willingness to use debt as well as influence credit ratings as it is expected to have a bearing on one's future income. Hence, a larger amounts of outstanding debt will be expected. However, the expected financial sophistication and/or financial management capabilities resulting from a higher educational attainment might influence prudent use of credit products and consequently, a negative relationship with the debt-burden. Results observed in Italy (Magri, 2007), the US (Dynan & Kohn, 2007) and Britain (Del-Río & Young, 2005) speak accordingly.

The ability to borrow can also be seen from the number of debt commitments and the size of outstanding debt held. Ideally, consumers are more likely to take on more credit commitments if they have the ability to do so. Theoretically, if borrowers' information is shared easily among lenders, consumers will be able to borrow from different sources and are able to accumulate larger amounts of debt subject to the credit limits (Zhu & Meeks, 1994). In addition, the closer to the credit limit, the higher the debt-service ratio. Evidence from the UK (Kempson, 2002)

suggests that the more credit commitments households had, the larger the proportion of their income that went into repaying debt and the more they were at risk of financial difficulties as evidenced from an increased likelihood of arrears. Furthermore, from their fixed effects and maximum likelihood estimations, Disney et al., (2008) found a significantly positive relationship between the number of commitments and the probability of consumers self-reporting debt problems or financial stress in the UK, while a Heckman procedure by Kim and De Vaney (2001) on U.S. credit card users found the number of credit cards held to have a significantly positive effect on the amount of outstanding credit card debt. In essence, these literatures suggest that while a heavy debt build-up can signal a consumer's creditworthiness, a high outstanding debt holding can be a precursor to yet a heavier debt-service burden.

4.1.3 Expectations

Studies such as by Cotsomitis and Kwan, (2006) for the European Commission and Ludvigson (2004) for the U.S, have investigated the impact of consumer expectations on household consumption patterns at the macroeconomic level. Their findings suggest that, all else being constant, consumer expectations and sentiments contain enough information to predict future changes in household spending beyond that already contained in past values of other available indicators.

At the micro-economic level households are more likely to increase their current consumption levels if they expect positive income growth (Hanna, Fan & Chang, 1995; Godwin, 1998) and can borrow more to finance current consumption while expecting to pay when their incomes increases. From their empirical analysis of American credit card holders, Kim and De Vaney (2001) found this observation to hold: their results indicated that higher expectations of future income were positively related to holding higher outstanding credit card debt. In addition, Brown et al. (2007) found that optimistic financial expectations impacted positively on both the quantity of debt and the growth of indebtedness among U.S consumers. The same results were found for the amount of unsecured debt held by British consumers (Del-Río & Young, 2005). Certainly, positive expectations of future income may influence consumers' willingness to take on larger amounts of debt. In case such expectations happen to be overinflated or simply fail to materialise, the consumers may realize later that they consumed beyond their means. Consumers with positive expectations of future finances will thus be expected to hold larger amounts of debt (both in absolute terms and in terms of the repayment burden) than those with negative expectations of future income.

This chapter attempts to contribute to this literature by analysing whether data on South African consumers speak accordingly. Unlike Chapter 3, which examines borrowing behaviours in an under-regulated market (i.e., prior to the implementation of the current regulatory regime), this chapter analyses consumption behaviours after the introduction of the regulatory reforms and establishes whether the regulatory objectives of enforcing and maintaining responsible and sustainable credit practices are coming to fruition. In particular, the analysis attempts to identify which key factors relate to consumer debt accumulation and therefore what kinds of consumers are likely to experience the heavier debt-burdens. This should help in determining whether the largest amount of consumer debt is held by consumers who are more likely to repay or those who do not. Which, should then have implications for the financial health of the household sector. Implications for future reforms to the NCA are also presented.

4.2 Hypotheses

Based on previous research and the assumptions put forth by the life-cycle theory of consumption and Katona's (1960) ability and willingness to consume exposition, several factors which affect the 'incidence' of consumer indebtedness (as noted in Chapter 3) should affect the 'level' of indebtedness (in terms of the total outstanding) in the same direction. Contrarily, the factors that positively influence lenders' decisions to lend should have a negative relationship with the debt-service ratio assuming consumers behave predictably. The following hypotheses are therefore formulated for this part.

Consumption needs: Consumers who experienced a decrease in income (assuming their credit ratings were still positive), those who are younger and those who are married are hypothesised to hold larger amounts of outstanding debts due to the various consumption demands resulting from these situations. Such consumers are also expected to have heavier debt service-burdens than those who are older, those who are unmarried and those whose incomes increased or remained stable. Due to the need for extra care (e.g., medical, etc.), experiences of ill-health or disability will have a positive relationship with the size of outstanding consumer debt and a positive relationship with the debt-service ratio.

Creditworthiness: The amount of consumer debt outstanding is expected to be positively related to a consumer's gross monthly income, education level, homeownership and the number of consumer credit commitments according to the ability to consume exposition. The consumer debt-service burden is expected to have a negative relationship with income, education attainment and homeownership. The consumer debt-service ratio is expected to be

positively related to the size of the outstanding consumer debt, and the number of consumer credit commitments held by the individual.

Expectations: It is hypothesised that the amount of consumer debt outstanding and the debt-service ratio are positively related to positive expectations of future income. Consumers who expect their incomes to improve will have a higher willingness to borrow and will thus borrow more than those with negative expectations of future income and as a consequence their debt-burdens will be heavier – as some expectations might be overinflated while for others, for various reasons, incomes might just fall short of expectations.

4.3 The survey and data

4.3.1 The survey

This study exploits information contained in Waves 1 and 2 of the National Income Dynamics Study (NIDS) conducted in 2008 and 2010 respectively by the Southern Africa Labour and Development Research Unit (SALDRU) at the University of Cape Town. At the time of the study, this was the most recent survey with enough information for the analysis of the level of households' indebtedness. The NIDS is a biennial panel study following the mobility or lack thereof of household members as they move from their original 7305 households or return to these households or set up their own (Leibbrandt, Woolard & de Villiers, 2009). Further waves of interviews were conducted in 2012 and 2014.

Like CAPS, the NIDS employed a stratified, two-stage cluster sample design in sampling households for the base wave. First, 400 Primary Sampling Units (PSUs) were selected from Statistics South Africa's 2003 Master Sample of 3000 PSUs (i.e., the Master Sample also used for Stats SA's Labour Force Surveys and General Household Surveys between 2004 and 2007 and for the 2005/2006 Income and Expenditure Survey (Ibid.: 9)). The sample comprised private households in all nine provinces of South Africa excluding some collective living quarters such as students' hostels, old age homes, hospitals, prisons and military barracks. Second, households to be included in the survey were systematically selected from the 2 (of the 8) non-overlapping samples of dwelling units (clusters) that had been drawn within each PSU but had not be used by Stats SA. All households living at the selected address/dwelling unit were interviewed. No substitution was permitted for dwelling units that were to be found vacant or that no longer existed.

As the NIDS is a panel of individuals (as opposed to households), individuals can be identified across waves by their unique identifier (*pid*) while different household identifiers are assigned

to each wave. According the NIDS Wave 2 technical paper, the household identifier is simply a tool to connect each individual to their household in each wave (Brown, Daniels, De Villiers, Leibbrandt & Woolard, 2013). The NIDS employed a household questionnaire to collect household-level information and an adult questionnaire to collect personal-level data. During the Wave 1 fieldwork, the adult questionnaire was administered to every adult (15 years and older) living in each sampled household. The realised sample size was 7305 households with a total of 31163 individual members. According to the set criteria, however, 2916 people were not resident members and were thus excluded from the study. The realised sample was therefore 28247 individuals including 17386 who completed the adult questionnaire (including proxies).

Of the possible 28247 individuals from the first wave, 22050 were re-interviewed in Wave 2 which represents a 19 per cent attrition rate. The analysis in this chapter is conducted only for the individuals who were successfully interviewed in both waves and therefore not affected by attrition. Since information on consumer debt was collected only at the individual level, this analysis exploits the individual-level data collected using the ‘adult questionnaire’. For those who completed the adult questionnaire, 13129 were interview in Wave 1 and then re-interviewed in Wave 2. This is the subsample adopted for this analysis.

The information on consumer debt was collected using a question which first asked the survey participants whether they held any one of 12 forms of consumer debt listed: personal loan (from a bank); personal loan from a micro-lender; loan with a mashonisa (a local word for underground lenders); study loan with a bank; study loan with an institution other than a bank; vehicle finance; credit card; store card; hire purchase agreement; loans from friends; loan from a family member; and loans from an employer. For each category of debt, participants were asked how much they spent in repayment last month and what was the outstanding balance at the time of the survey. Information was also collected about the respondents’ monthly incomes as well as their demographic information. Data from Wave 1 of the NIDS indicate that the incidence of any of these eleven forms of consumer debt was 18 per cent of the entire adult sample. By Wave 2 this had fallen to 12 per cent.

4.3.2 Measurement of variables

In this analysis, the unit of analysis is the individual (unlike the household-level analysis used for the CAPS data in Chapter 3). This may be preferable because resources and liabilities may not be shared equally – or shared at all – in a household. The sub-sample is restricted to

individuals who were aged between 19 and 70 during Wave 1 so as to keep the analysis within an age bracket considered to be the most credit-active. It is also (as noted above) a sub-sample of individuals in each wave, i.e. those who were successfully interviewed in both Wave 1 and Wave 2.

In the study ‘indebted consumers’ refers to individuals who reported having at least one consumer debt commitment – excluding housing loans – at the time of the survey. The level of debt is defined both in absolute terms as ‘total outstanding debt’ (a continuous summated variable of amounts outstanding on all consumer financial obligations at the time of the survey – excluding housing loans) and the ‘debt-service ratio’ (debt-to-income ratio) which is measured as the ‘required’ monthly consumer debt repayment relative to gross monthly income (excluding housing loans repayments). Maki (2000) opines that this ratio might be the best measure of the consumer’s immediate financial pressure (also referred to as ‘financial gearing’). He also notes that since voluntary payments such as prepayment on loans and payment above the minimum on credit cards would not suggest usual repayment behaviour, including such payments would highly inflate the repayment ratios and give a distorted picture of the consumer’s debt situation. Unfortunately, the NIDS survey does not differentiate between such payments – in case there were any – and, therefore, they could not be excluded from this analysis.

A continuous summated ‘monthly debt repayment’ variable was generated from the amount paid every month for each debt type (excluding housing debt) while gross income is the sum of all incomes received in a month from all sources by the individual. A self-reported variable depicting future income expectation is derived from two questions: one requiring respondents to provide their perceived income step at the base period (at the time of the survey), and the second requiring the respondents to provide their expected income step in two years (on a scale of 1 – poorest to 6 – richest). From these two questions a new dummy variable was created with the value of 1 for those who expected their income levels to be higher in two years’ time than they were at the time of the 2008 survey and 0 for those who expected their income levels to be lower or to stay the same. The number of credit commitments held by an individual is a continuous variable derived by counting the different debt types for which a respondent provided an outstanding amount.

Following Leibbrandt and Nyaruwata (2009:10), personal equity was measured as the respondents’ value of assets minus their outstanding debt. In doing this, a continuous summated

asset value variable was created from the ‘reasonable market value’ of all assets held subtracted from total outstanding consumer debt. Still, the value of the home is not included as this would otherwise create large inequalities in asset value between homeowners and the non-homeowners also because the analysis is restricted to consumer (non-mortgage) debt. Homeownership will, however, be used in the regression analysis due to its qualification as a modest proxy for ability to borrow. For this study – although it is an individual level analysis – it was possible to cross-reference the homeowner of the family dwelling to the personal code of the adult respondent. Therefore, the dummy variable homeownership takes a value of 1 for those individuals who were identified as the owners of the family dwelling in 2008. Other variables employed include educational level (a continuous variable, minimum 1: no schooling and maximum 8: university graduate). The dummy variable for being married is measured as 1 if married and 0 if single or divorced, while age is a continuous variable (between 19 years and 70 years). The values of continuous variables were restricted to within the 1st and 99th percentiles – to avoid extreme outliers that might otherwise seriously bias or influence estimates of interest and consequently result in wrong inferences (Osborne & Overbay, 2004). Table 4, below, presents the definitions of the variables of interest:

Table 4. Measurement of Variables

Variable	Measurement
Debt/income	Continuous: Ratio of total monthly debt repayment to gross monthly income in 2010.
Log(outstanding debt)	Continuous: logarithm of total outstanding consumer debt at the time of the 2010 survey.
Log(outstanding 2008)	Continuous: logarithm of total outstanding consumer debt at the time of the 2008 survey.
Log(income)	Continuous: Logarithm of gross monthly income in 2008.
Commitments	Continuous: The number of credit commitments held in 2008.
Income▼	Dummy: (decrease in income) 1 if the respondent’s 2010 income was lower than the 2008 income, 0 otherwise.
Equity	Continuous: Total asset value in 2010 minus total consumer outstanding debt in 2010.
Homeownership	Dummy: 1 if respondent owned the family dwelling in 2008, 0 otherwise.
Employed	Dummy: 1 if respondent was employed in 2008, 0 if unemployed.
Married	Dummy: 1 if married in 2008, 0 divorced or never married.
Age	Continuous: Between 19 and 70 years of age in 2010.
Age ²	Continuous: The squared term for the ‘Age’ variable.
Education	Continuous: minimum 1 (No education); maximum 8 (University).
Positive income expectations	Dummy: expected income level in 2 years (2008) higher than perceived 2008 income.
Ill-health/Disability	Dummy: 1 if had long-term illness or disability, 0 if no illness or disability reported (2008).

4.4 Distribution of debt

This section provides a descriptive analysis of the distribution of consumer debt among the NIDS sample of adult respondents and the sub-sample of adults who were interviewed in 2008 and re-interviewed in 2010. The distribution of consumer debt is analysed in terms of the absolute amounts held and size of monthly repayment relative to gross monthly income (the debt-service ratio).

During the first wave of the NIDS (2008) eighteen per cent (2808) of the entire adult sample ($n = 15598$) reported having a consumer debt while 21 per cent of those in the ‘credit-active’ age bracket (19 to 70 years) held a consumer debt. In the second wave, the incidence of consumer debt was 12 per cent (2033) of the adult sample of 16870 and 13 per cent (1592) of the sub-sample that was successfully interviewed in both waves.

Table 2, below, presents the participation rate in the various types of consumer debt. The highest debt participation of individuals was in retail credit (retail store cards) with 10 per cent of the entire adult sample and (56%) of the indebted sample in 2008 (6% for the entire sample and 52% of the indebted sample in 2010). Hire purchase ranked second highest in both waves. Use of credit cards was lower in 2010 compared to 2008 perhaps due the revolving nature of the debt, assuming that those who reported credit card debt had an outstanding balance from the month before. Participation in informal underground borrowing (mashonisa) was very low in both waves perhaps, suggesting the success of the new regulations in efforts to eliminate underground lending or simply a result of under reporting due to the negative connotations associated. It could also be explained by the typically very short-time nature of this type of debt such that very few people will have this type of debt at any one time but over the course of the year, many more people will have held such debt at some time or the other. The same explanation might be used for the surprisingly low rates of participation in micro-loans in both waves, – given that the microloan market has grown exponentially in recent years. Perhaps under-reporting might be a better explanation as a number of studies have suggested that despite the current efforts to eliminate them, underground lenders (mashonisa) including micro lenders operating on the fringes of legality and those who still keep borrowers’ ATM cards so they can withdraw repayments on payday have become even more ubiquitous and still play an important part in the overall indebtedness of South Africans (e.g., James, 2012; Krige, 2011; Mashigo, 2006).

There were significant differences in participation rates with regards to age in both waves of the survey consistent with the life-cycle theory of consumption. The participation rate increases with age and peaks at the 40-49 age bracket, then begins to drop steadily in an inverted-U shape pattern. This is consistent with results observed elsewhere, such as the 1995 and 2000 British Household Panel Survey (BHPS) (Del-Río & Young, 2005) where participation in unsecured debt peaks at the 35-40 age bracket and the 2007 US Survey of Consumer Finances (SCF) (Mann & Mann, 2007).

Table 5. Individual participation in various types of consumer debt

Consumers' participation in the various types of debt						
Debt type	Freq	2008		Freq	2010	
		% of Indebted (n=2857)	% of adult sample		% of Indebted (n=2,033)	% of adult sample
Retail credit	1592	56	10	1057	51	6
Hire/vehicle finance	836	30	5	467	23	3
Credit card	775	27	5	332	16	2
Bank loans	534	19	3	414	20	2.5
Family/friends	259	9	2	244	12	1
Mashonisa	139	5	0.87	158	8	0.94
Study loans	96	3	0.60	68	3	0.40
Micro-loans	83	3	0.51	51	2.5	0.30
Employer loans				47	2	0.30

4.4.1 Debt repayment

With regards to monthly debt repayment, a total of R3.2 million of the debtors' income was spent on consumer debt servicing during the survey month of the 2008 of the NIDS, which represents 14 per cent of their aggregate gross income that month (R23.3 million). The indebted respondents in the 2010 survey spent a total of R2.8 million during the survey month which represents 11 per cent of their total gross monthly income (R24.6 million). At the aggregate levels, this represents a relatively healthy financial state for the sampled population in both waves of the survey. Debtors in Wave 1 of the NIDS spent an average of R 1,356 per month (with a standard deviation of R2, 129) on debt servicing, while those in the 2010 survey spent an average of R1,135 on their monthly consumer debt servicing at a standard deviation of R1,864.

Table 6. Mean monthly consumer debt repayment by some selected variables

	Monthly debt repayment	
	Mean	Std. Dev
Gross income (Quintiles)		
Q1	R515	R702
Q2	R697	R1227
Q3	R575	R1088
Q4	R900	R1706
Q5	R1631	R2018
Total	R1131	R1737
Age		
19-29	R804	R1421
30-39	R1223	R1934
40-49	R1417	R2089
50-59	R1326	R1931
60-70	R640	R768
Total	R1172	R1848
Number of consumer debt commitments		
1	R698	R1365
2	R1545	R1854
3	R2592	R2509
4	R4003	R3168
Total	R1157	R1853
Marital status		
Married	R1415	R2072
Not married	R911	R1578
Total	R1158	R1853
Reduction in income		
Reduced	R1221	R2021
Increased/stable	R1240	R1837
Total	R1 236	R1878

The debtors in the subsample used for this analysis (individuals successfully interviewed in both Wave 1 and Wave 2), spent an average of R1,157 on monthly consumer debt servicing at a R1,853 standard deviation in 2010. For this group, there are striking variations with regards to the relationship between size of the debt servicing and the number of credit commitments held, gross income, changes in income; marital status and age (Table 6 above).

The size of debt servicing in 2010 increased with the number of commitments held in 2008. Debtors with a single commitment paid an average of R698 which increases steadily to R4,003 for those with four or more commitments. Income was positively correlated with the size of monthly debt repayment and significant at the $P < .01$ level. Perhaps consumer debtors choose to hold various smaller commitments as opposed to one or two larger obligation as a reflection of their various consumption needs. Debtors in the first quintile of income paid an average of

R515 in consumer debt servicing and this increased to R900 for those in the fourth quintile, and to R1,631 for the debtors in the fifth quintile.

A positive correlation is also observed between being married and the size of consumer debt repayment. Married debtors spent an average of R1,415 on debt repayments while those who were unmarried spent an average of R911. The payment for debtors who experienced a reduction in income between Wave 1 and Wave 2 was R1,221 while the mean debt repayment for those whose incomes increased or remained stable was only marginally higher at R1,240.

4.4.2 Debt-service ratio

This subsection describes the level of consumer indebtedness in terms of the ratio of debtors' required monthly consumer debt repayment to their monthly gross income (also called the debt-to-income ratio). The debt-service ratio is an important aspect of the credit underwriting process as it provides the narrowest measure of the debt-burden compared with other measures (such as total outstanding debt to income or debt-to-asset ratio). This is because the debt-service ratio is sensitive to interest rates or maturities that affect debtors' repayment capacity. From this ratio, underwriters are able to decide whether the consumer in question can keep up with monthly repayments of both the current and future obligations (May, Tudela & Young, 2004). Also, a high debt-service ratio is likely to constrain future consumption in a sense that *ceteris paribus*, a consumer with a relatively high debt-service ratio is more likely to be denied credit than one with a relatively low debt-service ratio (Johnson & Li, 2010). For consumers with heavy debt-service ratios, even small income shortfalls might prevent them from sustaining their borrowing. This also applies at the macro-level where larger shortfalls might trigger a rise in defaults, bankruptcies and banking sector credit losses (Juselius & Kim, 2011; Drehmann & Juselius, 2012).

Intuitively, the distribution of debt-service ratios among the adult population both in 2008 and 2010 is so clearly asymmetrical that the normal distribution assumption does not hold up as evidenced from Figure 1 below. The extreme positive skewness is informative of the fact that while a big proportion of the population may keep their indebtedness levels manageable, there are always a few who overextend themselves to unsustainable levels. For that matter, the low aggregated debt-service level observed earlier for all the sampled consumers might not be so telling. Over-indebtedness often affects a small proportion of debtors who often carry larger volumes of debts such that if they encounter repayment problems, the consequences will be

far-reaching (Chawla & Uppal, 2012). For this data, 75 per cent of the sample had a debt-service ratio that was below the mean.

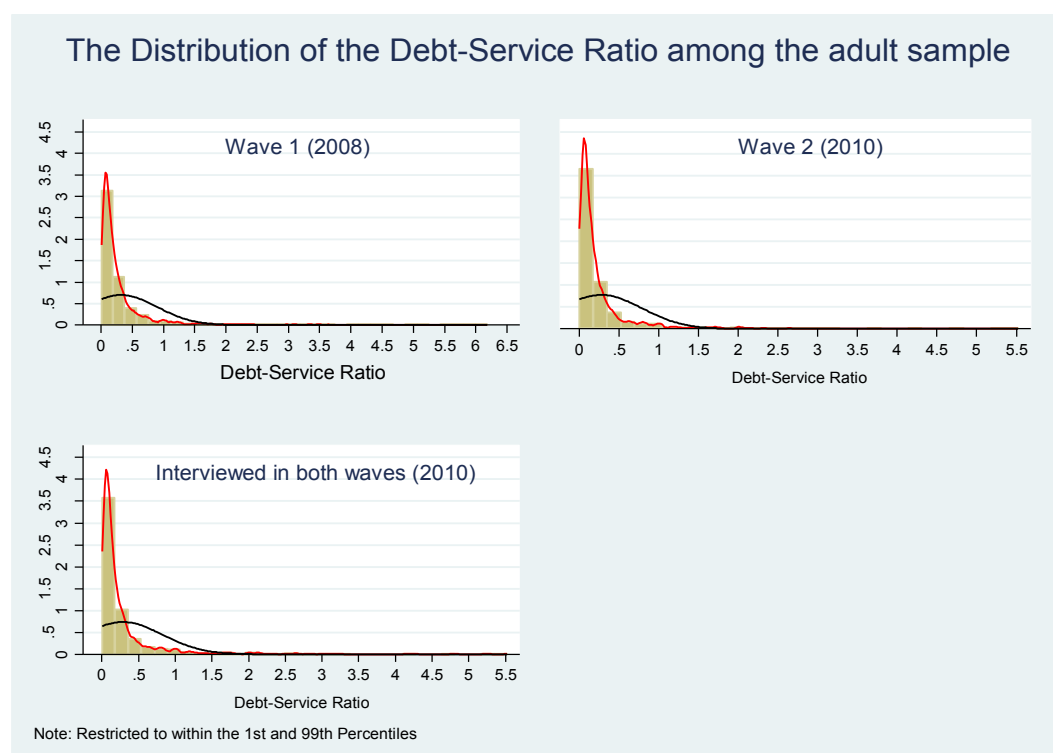


Figure 1. The distribution of the debt-burden among the sampled population

The mean debt-service ratio among debtors in the 2008 survey was 0.31 with a standard deviation of 0.47. This means that on average, these debtors spent 31 per cent of their gross monthly incomes on debt servicing. The debt-service ratio was slightly lower for debtors in the 2010 survey. Debtors in the 2010 wave of the survey spent an average of 28 per cent on debt servicing (standard deviation 51%). Generally, this should represent a relatively heavy average debt-burden in both waves especially given that housing loans repayments were not part of the analysis.

For the debtors who were successfully interviewed in both Wave 1 and Wave 2, the mean debt-service ratio in 2010 was 0.29 at a standard deviation of 0.54. At least 13 per cent of these debtors spent 50 per cent or more of their gross monthly income on consumer debt servicing while; six per cent spent 100 per cent or more on debt servicing. Both scenarios can be construed as being in a state of over-indebtedness.

Table 7. Distribution of consumer debt-to-income and total outstanding consumer debt

Distribution of consumer debt by some selected variables						
	Summary of debt-to-income ratio			Summary of outstanding debt		
	Mean	Std. Dev	Freq	Mean	Std. Dev	Freq
Gross income (Quintiles) [$r = -0.244$ (0.000)]				[$r = 0.078$ (0.010)]		
Q1	.49	1.3	93	R3, 383	R7 801	112
Q2	.47	.87	112	R4, 299	R11, 470	114
Q3	.42	.96	143	R4, 899	R12, 845	130
Q4	.31	.66	252	R6, 699	R15, 219	246
Q5	.20	.38	437	R17, 106	R29, 894	405
Total	.31	.73	1037	R10, 012	R22, 200	1007
Age [$r = 0.101$ (0.000)]				[$r = 0.048$ (0.047)]		
19-29	.37	1.59	236	R4, 580	R8, 131	276
30-39	.32	.64	329	R8, 943	R20, 652	341
40-49	.30	.84	312	R11, 058	R25, 596	313
50-59	.26	.46	224	R16, 359	R30, 842	220
60-70	.43	.86	82	R5, 342	R12, 445	77
Total	.32	.95	1183	R9, 604	R22, 250	1227
Number of credit commitment [$r = 0.126$ (0.000)]				[$r = 0.151$ (0.000)]		
1	.20	.51	876	R4, 012	R8, 955	848
2	.30	.60	293	R14, 854	R25, 147	302
3	.30	.44	86	R30, 916	R43, 578	90
4	.54	.97	27	R45, 781	R52, 402	29
Total	.29	.54	1282	9, 455	22, 073	1269
Education [$r = -0.218$ (0.001)]				[$r = 0.099$ (0.000)]		
No education	.32	.39	104	R3, 106	R10, 009	94
Pre-matric	.42	1.3	585	R6, 313	R15, 810	595
Matric	.25	.45	301	R9, 843	R21, 251	333
Post-matric	.24	.61	240	R18, 747	R33, 873	236
Total	.34	1.0	1221	R9, 340	R21, 983	1258
Marital status [$r = 0.060$ (0.018)]				[$r = 0.095$ (0.000)]		
Married	.30	.54	656	R12, 735	R27, 162	594
Not married	.27	.54	624	R6, 542	R15, 808	673
Total	.29	.54	1280	R9, 446	R22, 086	1267
Decrease in income [$r = 0.274$ (0.001)]				[$r = -0.004$ (0.893)]		
Yes	.51	.79	245	R10, 001	R22, 149	214
No	.21	.41	875	R11, 223	R24, 645	767
Total	.28	.53	1120	R10, 957	R24, 117	981
Ill-health or disability [$r = 0.102$ (0.000)]				[$r = 0.039$ (0.105)]		
Yes	.35	.67	381	R7, 567	R16, 652	369
No	.26	.48	896	R10, 145	R23, 810	895
Total	.29	.54	1277	R9, 393	R21, 988	1264
Positive income expectation [$r = 0.087$ (0.006)]				[$r = -0.021$ (0.448)]		
Yes	.31	.59	861	R8, 524	R19, 855	856
No	.25	.46	298	R10, 306	R25, 768	292
Total	.29	.56	1159	R8, 977	R21, 516	1148

Note: r refers to bivariate correlation coefficients and their significance level in parenthesis.

Table 7. Distribution of consumer debt-to-income and total outstanding consumer debt [Continued...]

Distribution of consumer debt by some selected variables						
Summary of debt-to-income ratio				Summary of outstanding debt		
	Mean	Std. Dev	Freq	Mean	Std. Dev	Freq
Personal equity	[$r = -0.101$ (0.000)]			[$r = -0.317$ (0.000)]		
Q1	.34	.69	204	R22, 306	R27, 419	208
Q2	.32	.59	194	R3, 834	R6, 440	233
Q3	.20	.24	184	R1, 283	R2, 238	221
Q4	.28	.57	184	R3, 349	R10, 424	218
Q5	.17	.31	194	R15, 535	R25, 331	211
Total	.27	.52	960	R9, 005	R19, 081	1091
Homeownership	[$r = 0.036$ (0.207)]			[$r = 0.039$ (0.154)]		
Yes	.28	.51	522	R11, 314	26, 084	464
No	.29	.58	654	R7, 372	R17, 459	700
Total	.29	.55	1176	R8, 943	21, 396	1164
Outstanding debt	[$r = 0.129$ (0.000)]					
Q1	.26	.42	182			
Q2	.24	.34	208			
Q3	.28	.53	214			
Q4	.34	.68	217			
Q5	.31	.63	224			
Total	.29	.54	1045			

Note: r refers to bivariate correlation coefficients and their significance level in parenthesis.

There are significant differences in the debt-service ratio according to monthly income, number of consumer credit commitments, total outstanding debt, ill-health, decreasing income, education, age and marital status ($p < 0.1$) for debtors who were interviewed in 2008 and re-interviewed in 2010. The results indicate a negative correlation between the debt-service ratio and the gross monthly income (Table 7). The average debt-service ratio was 49 per cent for consumers at the first quintile of income. This ratio falls steadily to 42 per cent for those at the third quintile, and then further to 20 per cent for those at fifth quintile of income. These results indicate that the debt-service is more of a burden for the lowest income levels and lessens as incomes increase. Similar results have been found for unsecured debt consumers in Britain by Del-Río and Young (2005). With regards to the number of credit commitments, a strong statistically significant positive correlation is observed. The average debt-service ratio for consumers with a single commitment was 27 per cent which increased to 30 per cent for those with three commitments and further to 54 per cent for debtors with four or more commitments.

Monthly debt repayment relative to monthly gross income was higher for married than for unmarried debtors. The average debt-to-income ratio for married debtors was 30 per cent and for unmarried debtors 27 per cent. Similarly, significant results can be observed for debtors who experience a decrease in income between 2008 and 2010, those who experienced ill-health in 2008 and those who expected their incomes to be higher (in 2 years) than what it was in

2008. With regards to the total outstanding debt, the result indicate a significant positive correlation ($r = 0.129$) between the debt repayment ratio and the size of the outstanding debt. While a significant positive correlation is observed, the direction of the relationship between the debt service ratio and age is not consistent. A decreasing ratio is observed with age until the 50-59 age bracket (from 37% to 26%) and then increases dramatically at age 60-70 (42%).

The preliminary results here suggest that the differences in the debt service ratios are likely to reflect the amount of borrowing undertaken in relation to consumers' attempts to maintain a certain level of consumption upon a background of personal income volatilities, or possibly inflated income expectations – as reflected in the positive relationship with factors such as ill-health, decrease in income, being in marriage and positive expectation of income – rather than the need to increase consumption from time to time. The importance of creditworthiness is also observed in relation to the negative correlation between the debt-service ratio and income.

4.4.3 Total outstanding debt

Total debt outstanding was calculated as the sum of the debtor's outstanding consumer debt payments from all consumer debt obligations excluding housing debt. The importance of total outstanding debt is related to the fact that 'ability to borrow' differs across individuals and households of different characteristics. Ability to borrow is likely to increase the level of debt held which might in turn affect the required repayments relative to income (e.g., Tudela & May, 2005). The results here indicated that the debt-service burden increased by 13 per cent for every Rand increase in outstanding debt.

A total of R29.8 million in outstanding consumer debt was held by the debtors in the 2010 survey while R31 million was held by debtors during the 2008 survey. For debtors who were successfully interviewed in both waves of the NIDS survey, the total amount held was R19.2 million and R24.2 million in 2008 and 2010 respectively. For this subsample, the mean consumer outstanding debt in 2010 was R9,455 (standard deviation R22,073) which, is considerably greater than the median consumer debt outstanding of R2,500 and therefore suggesting an extreme positive skewness as exhibited in figure 2 below. These graphs show that (just like the debt service ratios) absolute consumer debt levels are very unevenly distributed among the sampled population with only a small fraction of the sample holding the largest amount of this R24.2 million consumer debt, so much so that the average outstanding debt holding for 75 per cent of the subsample (R7,000) was substantially below the mean outstanding debt. This unequal distribution is perhaps symptomatic of the differing abilities to

borrow among the population (as may be reflected in the huge disparities in income and asset distribution) as opposed to the differences in consumption needs.

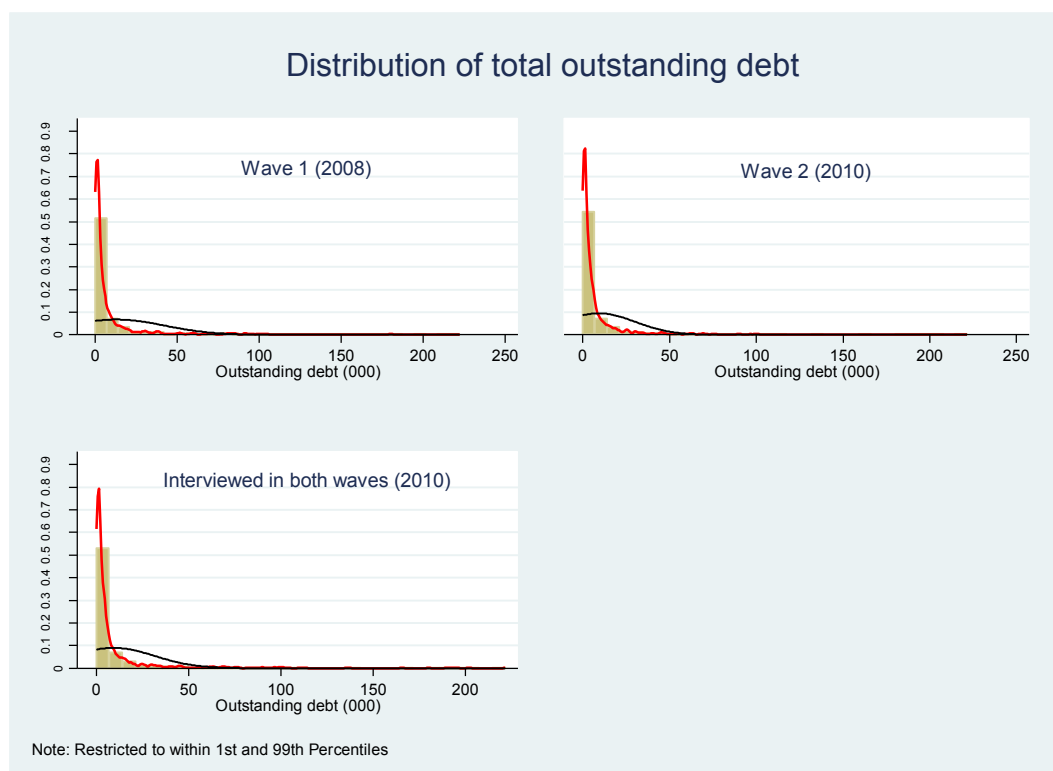


Figure 2. The distribution of consumer debt outstanding among the sampled population

Statistically significant differences were observed between the size of the outstanding debt and the consumer's income (Table 7). The credit practices of consumers are different depending on their income levels. Low-income consumers tend to use credit to help cope with budgetary troubles while those at a higher income might use consumer credit mainly to increase purchasing power or maintain an established level of consumption but also for luxuries. These objectives might then decide how much borrowing will be undertaken by the respective group. The results show that consumers at the first quintile of income held the lowest average outstanding consumer debt (R3,383), rising to an average of R4,899 for those at the third quintile, while those at the fifth income quintile held the highest average outstanding consumer debt (R17,106) albeit, at standard deviations more than double the mean at each quintile. Similarly, the number of credit commitments had a positive relationship with the size of consumer debt. Debtors with a single commitment had the lowest average outstanding debt (R4,012) and this increased to R30,916 for consumers with three commitments and further to R45,254 for those with 4 or more consumer debt commitments. The size of consumer debt held also increased with the consumer's education level and significant at the $p = 0.000$ level.

Average outstanding debt was lowest within the ‘no education’ group and highest at ‘post-matric’ level.

The total consumer debt outstanding was also positively related to being married and age. Married consumers carried considerably larger average outstanding debt compared to those who were not married at R12,735 and R6,542 respectively. With regards to age, consumer debt outstanding increases with age from an average of R4,580 for age group 19-29 years and peaks at R13,659 for age group 50-69 years and then drops to R5,342 thereby suggesting a possible quadratic relationship as observed in extant studies from other countries – in agreement with the life-cycle theory.

These preliminary results also suggest the importance of consumers’ borrowing power as reflected in the influences of income, education and number of commitments and therefore reflect rational market conditions. Pressure to bridge life-cycle consumption needs is also observable to a minor degree as reflected in the influences of marital status and age.

4.5 Testing the hypotheses

4.5.1 Methodology

Only 18 per cent and 12 per cent of the sampled population reported having an outstanding consumer debt in 2008 and 2010 respectively while only 13 per cent of individuals successfully interviewed in both waves reported being in debt. This means that the largest proportion of the sampled consumers were not in debt and could not be included in the analysis and as a result, the dependent variables – total outstanding debt and debt-service ratio – were truncated, implying the possibility that some observations on both the dependent variables and the regressors were lost when the choice was made to focus only on a subset of a larger adult population (i.e., (1) only adults who reported an outstanding consumer debt, (2) only adults interviewed in 2008 and re-interviewed in 2010) (see Wooldridge, 2010). In such a situation, using linear models such as Ordinary Least Squares (OLS) regression would lead to biased and inconsistent estimates of the coefficients (Maddala, 2001). Moreover, since individuals without debt were observable from the data, yet debt holding cannot be negative, sample selection bias was not considered to be a problem and therefore sample selection bias correction procedures such as the Heckman procedure were deemed unnecessary. For these reasons, the Tobit regression analysis with robust standard errors was chosen to estimate the coefficients of the predictors of consumer indebtedness levels and to allow for the fact that a substantially larger part of the sample reports no debt. The Tobit procedure is also necessary since the preliminary

analysis identified that some factors related to the ‘level’ of indebtedness were also found to be influencing the incidence of debt in the same direction.

The dependent variables – ‘total consumer outstanding debt’ and ‘consumer debt-service ratio’ – were derived from the 2010 data while the independent variables were drawn from the 2008 survey with the assumption that a consumer’s current indebtedness level is a function of past behaviours and/or past circumstances – (the exceptions were the age and the ‘decrease in income’ variables: decrease in income was derived from the observable differences between the two waves).

A quadratic term for age (age-squared) was included in the regression analysis to measure the apparent curvilinear effect on the level of indebtedness. The continuous variables ‘total outstanding consumer debt in 2008’, ‘total outstanding consumer debt in 2010’ and ‘monthly gross income in 2008’ were transformed to their natural logarithms in order to correct for heteroskedasticity which might also lead to incorrect inferences resulting from inappropriate tests of significance (Long & Ervin, 2000;¹⁰⁴ Baltagi, 2009). The natural logarithm for the debt-service ratio could not be used in the Tobit model as 90 per cent of observations had negative values however, the other logged variables did not have any values below zero and therefore were not deemed problematic in the Tobit model. In the model for consumer debt-service ratio, the dependent variable was censored at the 5th percentile as the lower limit and the 95th percentile as the upper limit. Since the outstanding debt was converted to its natural logarithm, only the right censoring was deemed necessary (at the 99th percentile).

The predictor variables were tested for multi-collinearity using a correlation matrix with the Pearson correlation coefficient benchmark of 0.50 ($r \leq 0.50$). For each variable tested in the resultant models, the significance level if applicable is reported at either $p < 0.01$, $p < 0.05$ or $p < 0.10$ (Tables 8). The probability of rejecting or accepting a hypothesis is specified at the 10 significance level.

4.5.2 Results

4.5.2.1 Outstanding debt

The results of the Tobit regression analysis for the determinants of the size of outstanding debt are presented in Table 8 below. The explanatory variables tested relate to those factors that induce people to use credit and are expected to be positively correlated with how much people

¹⁰⁴Long & Ervin (2000) define heteroskedasticity as the unequal variance of the residuals which usually happens when the variation in the dependent variable far exceeds the variation in the explanatory variables.

borrow or are able to qualify for when they enter the consumer credit market as well as observable factors that influence lenders' decisions to lend to some people and not to others. These factors are related, on the one hand, to the resources that signal creditworthiness or ability to borrow (i.e., monthly gross income and other proxies for income such as education level and homeownership and a direct measure of the actual ability to borrow – i.e., the number of credit commitments held), and financial expectations (positive income expectations) as a consumer's subjective assessment of own future capacity to repay and a possible influence of the willingness to borrow. On the other hand, consumption needs as represented by the age of the consumer (linear and squared term), a decrease in income, marriage and ill-health or disability. The significant variables in respect of the level of outstanding consumer debt were decrease in income, being married, ill-health/disability ($p < 0.10$), education, gross income and the number of consumer credit commitments. With the exception of decrease in income and ill-health/disability, the rest of the significant variables had coefficient signs consistent with expectations.

These results indicate that – holding other factors constant – higher-income consumers are more likely to hold larger amounts of outstanding debt than lower-income consumers and this is related to their ability to borrow. The size of the outstanding consumer debt was more likely to increase with the level of education and the number of consumer credit commitments held *ceteris paribus*. Insofar as these results can relate to supply-side effects related to lenders' selection criteria – especially with regards to the characteristics visible to lenders during a credit application (e.g., income) – they may also reflect demand effects associated with more consumer confidence about future income levels, which might positively affect willingness to borrow. These criteria are, therefore, expected to influence lenders' trust in an applicant's ability to pay the debt as and when it comes due and consumer's willingness to accept credit as a purchase tool.

Regarding the proxies for consumption needs, only the results for being married were intuitive. The results indicate that while holding other variables constant, the average consumer outstanding debt among married consumers was higher than the average outstanding consumer debt held by unmarried consumers.

Table 8. Tobit regression for outstanding consumer debt and consumer debt-to-income ratio

	Tobit regression models	
	Outstanding debt	Debt-service ratio
Independent variables	Coefficients and standard errors	
Decrease in income	-0.40*** (0.12)	0.21*** (0.02)
Married	0.22** (0.09)	0.02 (0.01)
Age	0.03 (0.03)	-0.00 (0.00)
Age ²	-0.00 (0.00)	0.00 (0.00)
Ill-health/disability	-0.18* (0.11)	0.03* (0.02)
Income expectations	-0.11 (0.11)	0.02 (0.02)
Homeownership	0.10 (0.10)	-0.01 (0.02)
Education	0.11*** (0.03)	-0.02*** (0.00)
Log (income)	0.38*** (0.04)	-0.08*** (0.01)
Number of commitments	0.94*** (0.07)	0.04*** (0.01)
Log (outstanding debt 2008)		0.04*** (0.01)
Intercept	2.72*** (0.56)	0.47*** (0.08)
N	840	784
/Sigma	1.27*** (0.03)	0.18*** (0.01)
ll	-1387.013	65.348
Pseudo R2	0.134	1.891

Note: Robust standard errors in parenthesis: *** p<0.01, ** p<0.05, * p<0.10

A decrease in income and ill-health status were both significantly negatively related to the size of the outstanding consumer debt. The average outstanding consumer debt among debtors who experienced a reduction in income between 2008 and 2010 was significantly lower than the average outstanding debt held by debtors whose incomes remained stable or increased during this period (p<0.01). This is possibly more a result of their reduced ability to qualify for debt in the market place than their indifference to borrowing. The same may be assumed with regards to the negative results for ill-health/disability as it is also negatively correlated with income.

While the signs on age and age-squared suggest a curvilinear relationship with the size of the outstanding debt and in line with the life-cycle theory postulation, both terms of the variable were insignificant. Also contrary to expectations, optimistic financial expectations and homeownership were not important in the size of the consumer debt held.

Generally, these results indicate that the level of consumer debt held is more a function of the consumers' ability to access credit (i.e., creditworthiness), and less about their consumption needs *ceteris paribus*. Resources (economic and/or personal resources) provide the ability to borrow which affects the absolute level of consumer indebtedness while the inadequacy of resources which was presumed to force consumers to borrow more in order to maintain their consumption levels in contrast, might mean reduced access to credit perhaps due to deteriorating credit ratings.

In summation, the results for outstanding debt suggest that lenders were applying rational lending practices. Although it could be expected that some consumers might have needed to borrow more to supplement their incomes (e.g., those who experienced a reduction in income), it is possible that the risk assessment measures applied by lenders constrained the level of indebtedness in some cases. The results might also suggest that the largest volume of consumer debt was held by consumers who were more likely to repay – to the extent that consumers' resources can inform this. Consequently, other factors being constant, lower incidences of delinquency would be expected. It should also be noted that income pressure might make some people indifferent to borrowing for fear of inviting further financial burdens. People have different ways of coping with negative incomes: some might choose to restrain themselves from taking on more commitments while others might decide to realise some of their assets. A point of caution could be that actual lending behaviours cannot be completely ascertained without data on rejections of consumers' applications. It is thus submitted that consumer-level differences in consumer debt holding and the factors that affect it can be more complex than hypothesised.

4.5.2.2 The debt-service burden

The explanatory variables gross monthly income and education were used to take into account the effects of resources on the consumer's debt service burden while both the size of the outstanding debt in 2008 and the number of credit commitments were used to measure the consumers' actual ability to borrow on subsequent indebtedness and its effect on the size of the debt-burden that ensues. A decrease in income, age, being married and having a disability/ill-

health were used to capture the effects of consumption needs on the size of the debt-burden. The effect of positive income expectations was also analysed.

The resultant significant variables were a decrease in income; ill-health/disability; education; gross income; number of consumer debt commitments; and total consumer outstanding debt in 2008. Income and education were negatively related to the size of the consumer debt-service burden. As had been hypothesised, consumers with higher incomes were experiencing lower debt repayment burdens than were lower-income consumers. While their buying power might lead higher-income consumers to borrow more – as is evidenced from the significant positive relationship between outstanding debt and income – the size of the resources they devoted towards servicing their indebtedness was likely to be low relative to their incomes. The negative sign on the education variable was also, as expected – possibly due to the positive relationship between education attainment and future income. There is also the relationship between education and decision-making. Higher education attainment is expected to improve numeracy and/or money management, and reduce the possibility of unwise consumption choices which might otherwise result into a heavy debt-service burden. Better educated consumers might better understand the workings of the credit market and the dangers associated with poor credit decisions. It may, therefore, influence moderation in consumption and although they might carry higher absolute debt levels, they might know better than to borrow beyond what their incomes can sustain.

The variables representing the direct measures of the consumers' creditworthiness and possibly excessive consumption (i.e., the size of outstanding debt and the number of credit commitments held) were, as expected, significantly positively related to the size of the debt-repayment burden. Other factors being constant the higher the size of the debt build-up and the more the number of consumer credit commitments, the heavier the repayment burden. This might be explained by the inability to monitor the different bills and also by the possibility that a high debt build-up is sensitive to negative transitory swings in income. Fewer commitments are easier to monitor, but as commitments pile up, there is a possibility that some bills will go unpaid. Even small amounts that go unpaid may accumulate to a substantial burden.

Two variables depicting resource strain – decrease in income and ill-health or disability – were, as hypothesised, significantly positive. These two situational factors suggest high consumption needs. Ill-health is usually associated with both extra costs, such as medical or professional care fees and lower resource endowment, while consumers who experience decreases in

income may require substantial borrowing to plug the shortfall. In both cases, consumers are forced to use debt to cope with budgeting troubles which may later translate into a high debt-service burden as bills continue to accumulate. Such consumers are to be found borrowing to finance such binding necessities as food, medication and school fees, as opposed to luxuries like sable fur coats. Although these consumers (who experienced a decrease in income, and ill-health or had a disability) were found to hold relatively lower outstanding debts, they were experiencing heavier repayment burdens.

The results for debt-service burden do not completely support the life-cycle theory of consumption as the debtor's age and marital status are not related to the size of the repayment burden. Financial expectations were also not found to be important in determining the size of the consumer debt-burden.

In summation, while consumers with positive ability to borrow (higher-income, higher-education) are less like to experience higher repayment burdens, a heavy debt build-up is likely to lead to heavier debt-service burdens even for such consumers. In addition, vulnerable debtors (those with negative incomes or experiencing ill-health) were more likely to experience higher debt-service burdens. It is likely that these consumers find it hard to cater for the extra costs resulting from these conditions and still keep up with their consumer debt repayments. They might abandon their obligations altogether to cater for such necessities as food and medical care.

4.6 Summary and conclusions

This study used the National Income Dynamics Survey, to examine the factors affecting the levels of indebtedness among individual borrowers in terms of the size of the 'outstanding consumer debt' and the 'consumer debt-service burden'. The debt-service burden was measured as the ratio of the required monthly consumer debt repayment to gross monthly income, while the total outstanding debt was the overall amount owed on all consumer debts. Eighteen per cent of the individuals had at least one form of consumer debt in 2008 and 12 per cent had reported being in debt in 2010. The sampled population (individuals who were interviewed in 2008 and re-interviewed in 2010), reportedly spent on average 29 per cent of their gross monthly incomes on consumer debt servicing in 2010. A small minority (13%), however, reportedly spent 50 per cent or more of the monthly incomes on consumer debt repayment, whilst 6 per cent reportedly spent 100 per cent or more of their gross income on debt servicing. These figures reveal an unhealthy level of indebtedness (especially given the

fact that only payments towards consumer debt are considered, excluding mortgage payments). This unhealthy level of indebtedness, however, is concentrated within a small minority of the sampled population which suggests that lenders were not exposed to large-scale default losses.

With regards to the total outstanding debt, debtors in the NIDS sample held an average of R12,738 and R9,136 in outstanding consumer debt in 2008 and 2010 respectively. For those in the sub-sample that were successfully interviewed in both waves, the mean consumer outstanding debt in 2010 was R9,455. These can also be considered as relatively large amounts, given the relatively shorter maturity for consumer debt. Even though some individuals have higher average debt levels than others (in terms of both total outstanding and the service burden), a far greater concentration in the distribution was observed, implying that a relatively small proportion of borrowers held a larger proportion of the total debt. Again, given the shorter maturity rates associated with consumer debt, keeping up with monthly repayments is vital and will determine whether consumers can sustain their consumption levels for long periods. Consumers who find themselves heavily indebted by consumer debt will be more sensitive to adverse changes in their incomes as repayments are often due within a short time yet they have to contend with recurrent day-to-day consumption obligations. The consequence is that such debtors will find it hard to reduce their indebtedness before it becomes a burden.

The results indicated that consumer debt was also more unequally distributed within some groups of borrowers than others. Although total outstanding debt was on average higher for higher-income debtors, these debtors on average faced a lower debt-burden and, therefore, the debt-repayment burden was heavier for debtors at the lower income levels. The findings also indicate that higher-income debtors on average paid more towards their debt servicing than lower-income debtors – which is intuitive given their absolute debt levels. Average monthly consumer debt repayment also increase with the number of commitments held while higher-income consumers were – on average – more likely to hold more credit commitments than lower-income consumers.

The total outstanding and the debt-service burden were found to be higher among married debtors than unmarried debtors, and while average outstanding debt was lower among individuals suffering from ill-health or disability, the average debt-service burden was higher for this group which is perhaps a result of having to divert resources to cater for these conditions. The debt-service burden was also found to be heavier for individuals with higher outstanding debt compared with those with lower outstanding amounts. While the total outstanding debt

increased with age and peaked at the 50-59 age group, then dropped for those at the 60-70 age group, the average debt-service ratio was highest for debtors at the 60-70 age bracket (43%).

In the regression analyses, the factors related to current and expected income were positively related to the size of the outstanding debt. These were gross monthly income and educational attainment – a possible proxy for future income. Positive income (current and anticipated) improves credit ratings and hence, access to credit. The number of credit commitments held – a proxy for credit sources or availability – also plays a significantly positive role in the size of the outstanding debt held. The results show that the size of the outstanding debt increased with the number of consumer credit commitments. Holding more credit commitments may suggest that such consumers have access to more sources of credit. Consumers with more access to credit can accumulate larger amounts of debt than those with limited access. A number of factors affect access to credit, including the knowledge and awareness of available credit products on the market, the consumer's level of financial sophistication and awareness of the market dynamics, locational factors, and the level of resource endowment.

The results for the variables related to consumption needs presented mixed results in relation to the size of the outstanding debt. A decrease in income and experiences of ill health or disability were found to be negatively related to the size of the outstanding debt. These results were unexpected, given the assumption that consumers who find themselves in such situations might be forced to borrow more to help deal with the budgeting troubles resulting from these circumstances. Nevertheless, these results are sensible, as it could suggest the natural consequence of credit rationing, given the associated negative incomes. A possible explanation might be that, if the negative incomes persist and their debt-service burdens worsen, lenders will reduce supply or discontinue altogether. Hence the lower absolute debt levels observed. Marriage had a positive relationship with the size of the outstanding debt, a result that was intuitive and in line with the life-cycle theory of consumption. Married people are expected to have more consumption needs than unmarried people. They satisfy some (and quite often most) of these needs through borrowing and thus should hold larger volumes of debt.

With regards to the debt-service burden, a negative relationship was found for income and education. While consumers with higher income and education were associated with higher levels of outstanding debt, their average debt-service burdens were more likely to be lighter than those with lower incomes and education. These results seem to suggest that these groups were borrowing within the constraints of the income and perhaps, maintained their monthly

repayments which kept their repayment burdens lower. The results for education could also suggest the importance of financial knowledge in credit use. Although such consumers might have good access to credit, they are able to maintain lower debt-service burdens because they attempt to make calculated financial decisions by keeping track of their spending, making ends meet where necessary, shopping around to get the best deals, and staying informed on developments in the credit market.

The number of consumer credit commitments held and the size of the outstanding debt were, as hypothesised, positively related to the debt-service burden. As such, a direct link between the size of the debt build-up and the capacity to service that debt build-up was established. Consumers who maintain a high level of indebtedness in absolute terms and those who take on more commitments risk becoming financially overstretched. A high debt build-up can be problematic as it becomes sensitive to swings in income while consumers with many credit commitments may find it burdensome to keep track of all the different bills. In both scenarios, debtors may start missing some payments and the debt burden might increase due to compound interest and fees. These results might also suggest that as the market continues to grow (which often correlates positively with growths in outstanding debts), there is a likelihood that consumers' average debt-service ratios will increase, leading to further deterioration in debt sustainability – at least periodically.

The two significant variables related to consumption need (decrease in income and experiences of ill-health or disability) were positively related to the debt-service ratio as had been hypothesised. While these two groups of consumers are associated with lower outstanding debt holding, the little credit they qualified for was a heavy burden on their finances thereby making them more financially fragile and may translate into more binding financial constraints going forward.

In a nutshell, the results indicate that, overall, the debt burden is relatively lower for most consumers in the credit market. There is, however, a small group of consumers who experience extreme levels of indebtedness for which the capacity to repay might be extremely low or completely lost. Lenders seem to adhere to optimal debtor selection measures, and thus the highest outstanding debt is likely to be concentrated among debtors who are more likely to repay. Problems might still exist though. The results have indicated that the debt repayment burden is likely to increase with the increase in the debt build-up. For consumers with access to unlimited debt, it is likely that they will reach a point when the debt becomes a big burden.

Perhaps it should not be a problem if lenders are able to recognise this point and discontinue lending until a greater portions of the outstanding obligations is paid off. The improvements in inter-firm exchange of borrowers' credit performances could aid lenders in this regard. The results have also shown that there are some vulnerable consumers who, even though they qualify for small amounts, the little they are able to take home is still a big burden for them. Such consumers can benefit from lower interest credit. Also, the fact that these vulnerable groups are less likely to hold large volumes of debt might be an advantage for the credit market as it suggests that the credit market might not be exposed to widespread defaults.

Distinguishing between consumers who are likely to be more highly indebted than others can help identify whether the debt is concentrated among groups with the capacity to maintain repayments or not. One of the objectives of the National Credit Act is to promote a sustainable, responsible and effective credit market. It is assumed that such a credit market is one in which the largest portion of debt will be in the hands of consumers who are less likely to default. The results of this analysis seem to concur.

4.7 Implications

The findings to some degree support the hypotheses formulated in this study. The notable exceptions were the negative relationship between the proxies for consumption need (a decrease in income and of ill-health/disability) and the size of the outstanding debt. On the whole, the findings suggest that responsible market practices were being observed. This is not only because more of the debt is held by consumers who are more likely to pay but also because only the small fraction of consumers were experiencing extreme repayment burdens. There is no evidence that borrowing is concentrated among high-risk consumers – the low-income, less educated, those experiencing health problems, or those with decreasing incomes. The vulnerability of such consumers is evident from the findings that, while they held very little of the absolute debt, they experienced the heaviest debt-service burdens.

On one hand, such a situation might suggest a lower risk of contractual losses for credit providers. On the other hand, this situation might present negative welfare implications. If the poor and economically vulnerable find themselves experiencing such heavy repayment burdens, it means that they will have limited opportunities for future consumption. These groups need a steady supply of credit to smooth consumption and, possibly, attempt to improve on the quality of life. With such heavy debt-service burdens, however, their ability to qualify for future borrowing is likely to weaken even further. Although the effect of age was not as important as

theory would suggest, there was an important finding that the average debt burden was heaviest for debtors of advanced age (60-70 years) and these debtors also carried a considerably larger average amount in outstanding debt (R5, 342). These could also be considered as vulnerable consumers, with the implication that some South Africans are carrying heavy debt into retirement.

The study also found that a heavy debt build-up is likely to lead to a heavier debt-service burden. This would make consumers more exposed to the possibility of default. Ability to borrow is a good thing, as it helps households improve their consumption possibilities and possibly stimulate the economy. However, a high debt build-up will be sensitive to severe idiosyncratic shocks resulting in high consumption volatilities and a reduction in the consumers' abilities to repay obligations timely, which may further suppress credit supply. Such a scenario would not only compromise family wellbeing, but could also lead to a macro-economic slowdown as evidenced from the recent global crisis. Moderation in credit use might be helpful.

The size of total debt in itself might not be so important, ability to maintain repayments matters more. Holding a large amount of consumer debt may not always be a problem if incomes were increasing or remain stable. However, there is no guarantee that consumers will not suffer from unexpected negative shocks which can render even moderate financial obligations suddenly unmanageable. Ill-health or a sudden job loss would cause a contraction in income, thereby triggering repayment difficulties. Further implication for consumer educators is to emphasise the need for some form of financial buffering – however modest.

Section 18(1)(c) of the NCA requires that the National Credit Regulator (NCR) report annually to the Minister of Trade and Industry about – among other things – the volume and cost of consumer debt, the market practices related to these and the implications for consumer protection. It is hoped that these findings in some way can contribute to such information. The implications for the regulator are that restricting consumer credit access and encouraging other measures that influence saving and insurance could help vulnerable consumers sustain their borrowing practices even against a background of mild shock. In addition, the NCR can do more to monitor compliance by credit providers with the requirements of pre-contractual disclosure including marketing and credit quotations. It is often easy for consumers to be less prudent if faced with a combination of the lenders' marketing ingenuity and their own consumption pressures. The requirement of credit quotations can help consumers to think twice

before deciding to buy. Without effective monitoring, however, lenders are less likely to comply with such requirements.

It was noted that both education and awareness of market dynamics have a potential to influence responsible borrowing. Financial educators and counsellors need to help consumers understand the importance of moderation in credit use and alert them to the need to periodically monitor their debt build-up and the potential risks of not doing so. Aggressive public campaigns calling for moderation in debt consumption, and the exercise of the traditional African values of thrift are proposed. Such campaigns have been used to great acclaim in fights against smoking, drugs and alcohol. All in all, it can be concluded that there seems to be a relatively good degree of responsibility in the credit market which suggests, further, that perhaps the credit legislation and policy might be achieving its objectives in this regard. There are precise implications for consumers: be alert and tread carefully, resist the odd temptation to increase your credit limit especially if you can do without it.

The limitation of the study is its inability to examine the potential effects of other factors such as the interest rate, credit attitudes and repayment history especially since these were very important issues of contention during consideration of the current credit law in parliament. The information to explore these variables is not available in the data used. The study is thus unable to analyse the actual cost of debt and its effect on the debt build-up and the debt burden; the direct relationship between the debt size and repayment performance as well as attitudes and the level of borrowing undertaken. Additionally, it is suggested that future studies attempt to combine survey data with lenders' (loan-level) data (where possible) to get a better picture of the consumer's overall indebtedness situation and the lenders' actual lending behaviours.

Since the amount of borrowing undertaken is positively related to the ensuing repayment burden, it is also possible that some of the factors determining the level and burden of debt held also affect the repayment performance. As such, inability to pay consumer debts when due will be symptomatic of a high level of borrowing undertaken, relative to available resources and occurrence of financially adverse situations beyond lenders' and consumers' control. The next chapter attempts to test whether data on South African households speak accordingly. The chapter examines what kind of consumers are likely to face repayment difficulties on their consumer debts – allowing for the fact that some consumers are more likely to repay their debts (when due rather than later or not at all) than others. In doing so, further implications for credit regulation are explored.

Chapter 5: Consumer debt repayment problems

Abstract

The policy document that preceded, and gave ‘policy direction’ to the NCA blamed consumer debt repayment difficulties entirely on irresponsible credit market practices. However, literature on consumer debt problems suggests that debt delinquencies can also result from factors beyond market behaviours. This chapter examines what kind of consumer was at risk of defaulting on a consumer debt. It distinguishes between an inability to repay when the household is hit by a financially adverse event (such as loss of employment or death of a breadwinner) and chronically excessive spending (which makes households financially over-extended and therefore less able to meet all due financial obligations). Data from the Cape Area Panel Study suggest that adverse changes in family situations that reduce incomes or increase demands on available resources affect debt repayment performance more than excessive spending. This suggests that the government’s emphasis on the ‘prevention’ of consumer over-indebtedness might not solve problems of defaulting on payments. The problem lies not so much in the credit market behaviours as in the frequency of devastating shocks.

Keywords: CAPS; Default risk; Delinquency; Excessive borrowing; Negative shock

5.1 Introduction

Maintaining a good credit record is an important aspect of a household's financial life. Many debtors pay back their debts without interruptions, but, for a number of reasons, some end up falling behind on payments or stop paying altogether. If debtors become delinquent (i.e., fail to make monthly payments as they fall due),¹⁰⁵ it often becomes part of their credit record with the consequence that their capacities to qualify for future lending will be highly compromised. In practice, if borrowers exceed 90 days of delinquency (or are three payments behind), they are considered to be in default. The creditor may then decide to write the debt off the books or institute legal measures to pursue repayment. All these are negative outcomes both to the delinquent debtor and to the lender, and thus underpin the necessity of an effective consumer credit regulatory framework.

Although consumer debt repayment performance has been a subject of wide-ranging scrutiny in South Africa, little formal research (using household survey data) has been done on the subject. The government has expressed its concerns about this problem both prior and after the implementation of the current credit regulatory regime. Policy makers, the mass media and other commentators have often singled out irrational market behaviours related to abusive lending practices and consumers' lack of knowledge as the cause of the problem. Perhaps it is for this reason that the NCA's main focus is on prevention of these market problems with very little attention paid to managing the possible outcomes.

Since the 2006 introduction of the NCA, the National Credit Regulator (NCR) and Statistics South Africa have been publishing aggregate statistics which show a rising trend in consumers' debt repayment problems notwithstanding the current regulatory efforts to prevent irresponsible market behaviours. Given this scenario, one might argue that perhaps factors other than market behaviours might also have an important role to play in consumers' debt repayment performances.

An attempt is made in this study to address this query by examining data on South African households. In doing so the study attempts to establish whether consumer debt delinquencies are more likely to result from households spending excessively and rendering themselves

¹⁰⁵ The National Credit Regulator (NCR) provides three classifications of accounts: (1) account in good standing (an account which is current or on which the client has not missed more than one or two installments, and has no judgments. (2) impaired account (an account which is either three or more payments in arrears, or has an 'adverse listing', or that reflects a judgment or administration order; and (3) adverse listing (accounts with adverse classifications such as 'slow-paying', 'absconded', 'default', 'handed over' and/or 'write-off').

financially overstrained or from financially adverse events that befall consumers and erode their repayment capacities. Debt repayment performance can reflect not only the financial health of the household sector, but also the necessary direction for regulatory reforms. This study thus also aims to put the current regulatory framework into perspective.

In terms of theory, consumer debt defaults have often been viewed as a consequence of a genuine inability to pay (as opposed to being a strategic decision) when household resources become too strained to satisfy all financial obligations. This is related to the ‘cash flow’ theory of defaults¹⁰⁶ which is based on the assumption that debtors will avoid arrears as long as their income flows are sufficient to cover their debt repayments without undue financial stress (Jackson & Kaserman, 1980). This theory assumes that consumer debt delinquencies are more likely to occur whenever consumers experience unexpected deteriorations in income, disruptions in the family budget or when the debt-burden exceeds the debtor’s capacity to repay. Negative transitory income will have a negative impact on the monthly repayment-to-income ratio and the consumer’s repayment burden will increase (often suddenly), thereby making it almost impossible for the consumer to continue with scheduled repayments without undue stress on the family’s economic wellbeing. Abrupt changes in a consumer’s circumstances and the level of indebtedness will thus determine the consumer’s debt repayment performance (Jackson & Kaserman, 1980; Keese, 2009; Alfaro et al., 2010).

While empirical studies conducted mainly in the United States and Europe have often provided differing results in respect of the different variables, almost all results have been consistent with the cash-flow theory. A number of such studies have found financially adverse events – often unanticipated by both the lender and borrower at the time of the credit agreement – to explain consumer debt repayment difficulties (e.g., Getter, 2003; Avery et al., 2004; Farinha & Lacerda, 2010; Grant, 2010).

Getter (2003) finds that for the United States the occurrence of negative events (that neither the lender nor the borrower could have anticipated at the time of evaluation of the credit request) is more related to consumer debt delinquencies. He notes that building financial assets helps reduce the likelihood of delinquency as these can provide insurance against negative

¹⁰⁶Also called the ‘ability to pay theory’ of default. The alternative theory is the ‘equity theory of default’ which involves rational borrowers who attempt to maximise the equity position in the mortgaged property at each point in time. They cease payments if the market value of the mortgaged property declines sufficiently in relation to the outstanding balance at any time (Alfaro et al., 2010).

shocks. A related finding is that family structures that are less sensitive to shock have a lower probability of default (e.g., in the case of married couples with two incomes (Avery et al., 2004 – for the U.S) or families with more people who contribute to the total family income (Alfaro et al., 2010 – for Chile). For a study on EU households, Grant (2010) finds that delinquencies are more likely to be found in households in which the household head has suffered a serious economic shock over the last year.

The alternative view blames debt repayment difficulties on lending and borrowing practices that allow some households to consume excessively, thereby becoming over-burdened with more debt than they can afford to repay (Rinaldi & Sanchis-Arellano, 2006; Bertaut, Haliassos & Reiter, 2008; Farinha & Lacerda, 2010; Alfaro et al., 2010; Zhu, 2011; Gathergood, 2012). Bertaut et al. (2008) find that consumers may experience repayment problems either because they have no regard for the cost of credit they consume and hence discount the burden of repayment, or they do not receive enough information (including the true cost of credit, terms of contract) to make informed decisions. In the same vein, a study in the U.S by Gathergood (2012) found that lack of self-control and financial illiteracy is associated with excessive financial burdens and consequently non-payment of consumer credit.

Contrarily, Getter (2003) argues that if credit markets work predictably and lenders apply optimal underwriting standards, they will be able to detect and eliminate consumers who are more likely to default. It will then mean that later delinquencies will not result from the fact that debtors borrowed excessively, but from adverse changes in the debtors' circumstances that might happen after agreeing to a credit contract. The level of debt will thus only suggest solvency rather than credit risk. Given this observation, one may further argue that the debtor's observable characteristics (which infer creditworthiness) at the time of the credit request might not be enough to determine whether the debtor will become delinquent or not.

Following an empirical strategy similar to Getter's (2003) for default risk in U.S. households and Peter and Peter (2006) for households in Australia, the study proceeds to examine the relative importance of excessive consumption and financially adverse events on consumer debt delinquency among South African households. This is done against a background in which some households are more likely to pay than others and therefore the study controls for some of the characteristics that lenders use to gauge borrowers' creditworthiness.

Using household-level data from the 2002, 2005 and 2006 waves of the Cape Area Panel Study (CAPS), this study provides an empirical analysis of the debt repayment problems of South African households during the period preceding the introduction of the new credit market regulations which were a direct response to such problems. Most narrowly, the study aims to examine whether debt repayment problems (during that time) were better explained by excessive consumption or by unfortunate circumstances beyond which consumers or lenders might have no control. Second, and most important, (given the fact that debtor repayment problems are still on the rise seven years into the new regulatory regime), the study attempts to provide an understanding of what areas of the credit regulatory framework might need further attention. The study progresses as follows: some existing literature on debt default in South Africa and elsewhere is presented followed by a definition of the variables of interest and sample statistics and presentation of the results of the analysis. It concludes with a discussion and implications.

5.2 Literature review

There has been very little formal analysis of household debt repayment in South Africa but there is a substantial literature on the situation internationally. In most of these literatures a picture of two consumers is presented: one taking on an unreasonable amount of debt (for example, due to impulsive buying behavior, irrational optimism about future income, lack of disclosure of credit costs, deception etc.) and later finding himself overstretched and unable to repay. Another picture is a consumer who might borrow a reasonable amount and stick with his budget, but may still find himself unable to pay due to unfortunate events that might follow (e.g., a sudden inability to work through injury or illness or experiencing a divorce). The DTI's policy document that preceded the NCA (a policy framework for consumer credit) blamed the South African consumer debt problems entirely on the first scenario. More specifically, 'unaffordable use of debt especially among the poor due to deception and weak disclosure by lenders (dti, 2004b:13) were seen as the culprits.

An empirical study that analysed consumer indebtedness in South African households by Hurwitz and Luiz (2007) using data collected in 2003 found that while some households had a genuine inability to repay their debts due in part to emergencies that strained their cash flows, for others reckless behaviours both by lenders and consumers were found to be major causes of debt problems. A 'reckless culture of non-payment' was observed by these authors in a sense that some people deliberately borrowed more than they could afford to repay, noting that 'they

have to have it now, for Christmas, even if they know it will get repossessed in January' (ibid.: 114). Such behaviours were attributed to the low levels of formal education and financial literacy as well as a lack of experience in managing credit. These findings are largely consistent with the causes reported in the above mentioned policy document and seem to reflect the outcomes of a weak regulatory environment that existed. However, the study also found that many debtors were wary of defaulting on their obligations but often chose to do so whenever they found themselves under financial pressure: an observation consistent with the cash flow theory of default.

While there exists a large body of literature from other countries on delinquencies in the housing debt market (e.g., May & Tudela, 2005; Peter & Peter, 2006; Ho & Pennington-Cross, 2006; Bandyopadhyay & Saha, 2009; Goodman & Smith, 2010; Elul, Souleles, Chomsisengphet, Glennon & Hunt, 2010), delinquency in non-housing consumer debt markets is still an understudied topic. There are few studies looking specifically at credit card delinquency (e.g., Stavins, 2000; Gross & Souleles, 2002; Agarwal & Liu, 2003; Lopes, 2008) while a few others do not distinguish between housing debt and non-housing consumer debt in their analyses (e.g., Getter, 2003; Avery et al., 2004; Grant, 2010). In all these literatures, the results suggest two broad causes of poor payment performances: excessive consumption and economic shock.

5.2.1 Excessive consumption

It has been submitted that some consumers borrow excessively because they tend to overestimate the immediate benefits of the credit while undervaluing its future costs at the same time. In so doing, they accept as much credit as is available to them, regardless of whether they have the confidence in their capacity to repay or no (Meier & Sprenger, 2007). Others simply have no self-control or have a low level of knowledge about financial matters (Gathergood, 2012). There are also external market factors that might influence consumers to spend excessively, such as falling interest rates (Jappelli et al., 2009; Guttman & Plihon, 2010), lenders' non-disclosure of important credit information and other deceptive practices (Hill & Kozup, 2007). Indeed, a field work experiment in South Africa by Bertrand, Karlan, Mullainathan, Shafir and Zinman (2010) found that consumers could easily be manipulated into accepting credit they would otherwise have not considered through deceptively designed randomised advertising content.

Several empirical studies using the level of indebtedness as a proxy for excessive consumption have had inconclusive results. Godwin's (1999) study of U.S. households found that the more financially overstretched a household might be (especially regarding size of required monthly repayments) the more likely it will experience repayment problems. Using the size of the households' debt portfolio consisting of six types of debt (credit card debt, mortgage loans, automobile loans, durable goods loans, home improvement debt, and other debt), as well as the amount of the outstanding balance of each of these types of debt, the Godwin study found that households which held the three types of debt (mortgage debt, automobile debt, and durable goods debt) simultaneously were significantly more likely to be financially over-stretched and thus more likely to experience debt repayment difficulties.

Similar studies in the U.S. found that consumer accounts with larger balances and larger purchases were more likely to end up in default (Gross & Souleles, 2002) and high credit limits (which might suggest a higher likelihood of over-indulgence) were associated with significant increases in credit card default rates (Lopes, 2008). The Lopes study notes, further, that an increase in the credit limit generates an immediate and significant rise in the level of indebtedness, even for individuals starting below the credit limit.

Similar results were found for other countries. The number of credit commitments was found to have a positive effect on the incidence of arrears on any type of household debt in British households, possibly due to the positive correlation between the number of commitments and the size of debt owed (Whitley et al., 2004; Disney et al., 2008). For households in Portugal, the number of banks to which the consumer is indebted and the size of the debt repayment were found to be significantly positively associated with consumer debt repayment difficulties (Farinha & Lacerda, 2010), and similar results were found in Chile (Alfaro et al., 2010).

In another study using country level quarterly time-series data of seven Euro-zone countries,¹⁰⁷ it was revealed that while a household's overall debt burden can be a source of payment problems (on any type of debt), it is of significance only in the long run (Rinaldi & Sanchis-Arellano, 2006). This study suggested that, other things being equal, if there are increases in real disposable income, consumers can continue to maintain relatively higher debt ratios without abandoning their obligations.

¹⁰⁷Belgium, France, Finland, Ireland, Italy, Portugal and Spain.

A negative relationship between excessive consumption and delinquency, however, was found in the time-series study on households in the U.K. and the U.S. by Jappelli et al. (2008). They found that although the lower interest rates in the mid-1980s had incentivised households to overspend (which resulted into the debt build-up), the periods of overspending were negatively correlated with insolvencies in both countries. For the U.S. Getter (2003) employed the ratio of monthly payments to monthly income (indicating that it reflects the household's immediate financial stress) to proxy for overspending and found this ratio to be insignificant in his default risk model. He acknowledges, however, that consumers with heavy repayment burdens will be sensitive even to minor shocks which, might force them to default.

In summation, it can be noted that there is indeed enough evidence to suggest that market behaviours play an important role in the level of spending and that excessive spending is likely to result in debt repayment problems. Although there might be other factors (only known to the consumers) that might force them to overspend, market practices for instance lax lending criteria – that might allow an already over-stretched debtor to qualify for more debt (e.g., James, 2012) – will still intervene. For that matter, pre-contractual regulatory interventions that remove incentives for opportunistic market practices; improve consumers' decision-making and enforce lenders' adherence to responsible lending practices should help to curb excessive consumption (Stoop, 2009; Campbell, Jackson, Madrian & Tufano, 2011).

5.2.2 Socio-economic shocks

Even where consumers take on a 'reasonable' amount of debt, with every intention (and means) to repay, debt repayment problems have been found to occur. This can be explained by misfortunes or financially adverse events (e.g., a job loss or an injury) that cause substantial declines in income (Agarwal & Liu, 2003; Getter, 2003; Avery et al., 2004; Keese, 2009; Grant, 2010). Ideally, consumers who qualify for credit are those whose future repayment capacities can be quantified and positively established using available information on their resources and past payment performance (Fellowes, 2009). Those with less favourable information and/or those with no information will often be denied access to credit so that the probabilities of future repayment problems can only be explained by trigger events that could not have been anticipated at the time of the credit application other than because they consumed excessively (Getter, 2003). Unanticipated events such as unemployment shocks, negative income shocks and/or health shocks are likely to trigger repayment difficulties even for those who attempt to consume within their means or who passed lenders' due diligence (Jentzsch & Riestra, 2006).

Such events, therefore, represent a random component to credit risk that is not observable to the lenders at the time a credit application is approved and should explain in part why borrowers fail to repay their debts, even when they seem to borrow within their means (Getter, 2003; Avery et al., 2004).

Empirical studies in the U.S. have found factors such as suddenly becoming unemployed, income becoming unusually low and getting divorced to increase the likelihood of consumer debt repayment problems (Getter, 2003; Lee, 2009). The explanation given is that these situations are sometimes quite abrupt and often catch consumers unawares. They thus find that continuing to honour their credit commitments might lead to further deterioration in their wellbeing.

A study on a sample of EU countries by Grant (2010) investigated the effect of three shocks on consumer debt repayment performance (i.e., whether the household head has become unemployed over the last year, whether the household has suffered a significant decline in income, and whether the household self-reports that the income situation has got worse over the last year). All the three shocks were found to have a significantly positive relationship with arrears. The same study also found that family situations that suggest a higher sensitivity to shock were positively correlated with arrears. For instance single parent households were more likely to fall into arrears compared with couples, because single parents might be more exposed to risk compared with couples, especially, if the couples have two incomes. In addition, the incidence of arrears increased with the number of children, possibly due to the inherent propensities for impromptu risk situations in families with children.

The study by Disney et al. (2008) attempted to pick up the effects of changes in household situational factors in a study of consumer delinquency in U.K. households (i.e., being in a couple/lone parent or being in and out of employment). While their study found current couple and work status to be weakly significant on their own, the possible changes experienced by the debtor as she/he transitions between these states were found to have a hugely significant impact on current arrears. Notably, marital separation and abrupt changes in work status (either becoming unemployed or obtaining a job) of the debtor, significantly increased the likelihood of failing to honour financial obligations. Such a situation can be explained by the abrupt interferences in one's daily life. For example, going out of work may have a negative effect on income during the transition, while starting a new job often requires many adjustments, some of which require spending money even before one's first pay cheque, and during this time the

debtor may be unable to attend to other financial obligations at least until the next pay cheque. These authors also found the number of dependent children to have a significantly positive relationship with debt delinquency. Related results were observed from a U.S. study (i.e., financial problems while adjusting to new situation) in respect of a consumer's changes in marital situations. Avery et al. (2004) found that newly divorced or separated debtors exhibited the highest estimated likelihood of defaulting on new accounts, and the likelihoods of default for these debtors was even higher than that for the 'never married' group.

With regards to mortgage debt delinquency, the effects of shock have been mainly analysed using macro-economic effects. Variables such as rising unemployment rates, as noted in the U.K. by Whitley et al. (2004) and in Australia, Peter and Peter (2006) found the volatility in home loan affordability (resulting from the volatility of income, employment rate and interest rates) as measured in the loan-to-value ratio of the property to be positively associated with mortgage default risk. According to Tsatsaronis and Zhu (2004), changes in interest rates relate to the behaviour of inflation and erodes property valuation which forces mortgage holders to default in order to avoid repaying more than the property is worth.

In summation, the importance of shocks in debt delinquencies presents a dilemma for credit-scoring systems as risk assessment is generally based on observable characteristics, yet shocks tend to be unobservable and unanticipated especially at the time of the assessment. Credit scoring systems could benefit from measures that control for households' level of exposure to shock. In terms of the regulatory solutions to debt repayment problems, the importance of shocks to debtors' payment performance means that even with good regulations to prevent irresponsible use of debt, consumers will still face repayment difficulties which, might necessitate 'aftercare' services for such debtors. This speaks to measures that can provide unfortunate individual debtors with some form of consumption insurance after the occurrence of a negative financial shock (White, 2007) while, also protecting these unfortunate debtors from overdue bills and civil actions from creditors, such as liens, repossessions, or wage garnishments (Himmelstein, Warren, Thorne & Wollhandler, 2005).

5.2.3 Other factors

Aside from households' consumption levels and economic or demographic shocks, another stream of literature looks at institutional factors. There it is argued that regulations on predatory lending and insolvency are relevant in explaining the variations in consumer (and housing) debt delinquencies across countries. Household economic characteristics (often used in lenders'

scoring systems), have also been applied in explaining households' consumer debt repayment performances.

Economic characteristics such as income, financial buffers (e.g., saving and insurance) and other assets have also been used to account for debt repayment performance in a sense that these either shield households from the negative effects of shock (Reeder, 2004), or serve as indicators of credit quality. Divided results have been found as well. Some studies such as Stavins (2000) and Martin and Hill (2000) found income to have a negative relationship with delinquency while Jacobson and Roszbach (2003) found no relationship between income and the probability of experiencing debt repayment difficulties. Getter (2003) found a negative relationship between homeownership and repayment delinquency while Martin and Hill (2000) found no relationship in this regard.

With regards to the institutional factors, studies have found that the decision to default on any type of debt may depend on the cost of default (including any legal costs and the consequences thereof). More specifically, the incidences of default are more likely to be higher in markets where punishments for defaulting are less severe, such that, debtors weigh the cost of sanctions for non-payment against the cost of continuing with payments and choose non-payment if the burden of payment outweighs the cost of sanctions (e.g., Athreya, 2002; Wong, Fung & Fong, 2004; Chatterjee, Corbae, Nakajima & Rios-Rull, 2007). The ease with which creditors can recover bad loans (Duygan-Bump & Grant, 2009), the effectiveness of a country's predatory lending laws (e.g., Goodman & Smith, 2010; Ho & Pennington-Cross, 2006) and the tightness of information sharing regulations (Jappelli et al., 2008; Duygan-Bump & Grant, 2009), all are reported to have an effect on debt delinquencies.

In a nutshell, it is possible that the factors discussed in these extant literatures can interact to increase the probability that a consumer will experience debt repayment problems. Some consumers might be treading on the edge with heavy debt burdens or huge outstanding bills which renders them more sensitive to trigger events and, consequently, an erosion of their repayment capacities.

Due to the dearth of empirical studies on consumer indebtedness in South Africa the variables used for this analysis are, for the most part, drawn from this extant literature. This also has an added benefit in a sense that if similar results can be found, then the South African credit market was not a special case and therefore can benefit from a regulatory transplant. This study,

however, contributes to this literature by contrasting between the relative importance of excessive spending and household shock on the debt repayment performance during a period which was documented to be characterised by under regulation and wide-ranging reckless credit practices. It could be expected that in such a period of inadequate regulation, excessive consumption might be more important in explaining the debt repayment problems of consumers, and that regulatory interventions to ‘prevent’ irresponsible credit behaviours would go a long way in solving the problem. Since debt repayment problems have only continued to grow (after implementation of such interventions), it is then possible that other factors might have played an important role as well, and these would have implications for the kind of regulatory interventions in place.

5.2.4 Contextualising shocks

Because the literature reviewed here is based mainly on experiences from the developed world, it is important to recognise the contexts in which this literature was written and its differences from South Africa as a ‘developing’ country with regards to shocks. Compared with South Africa, shocks are relatively rare in the ‘developed world’. There unemployment rates are low, and many people who experience job losses often find other jobs after a short duration of unemployment. Similarly, health is a less common cause of massive shifts in earnings and a less common problem compared with South Africa. Many households in these countries, in addition, are insured against such shocks in case they occur. Health and life insurance, unemployment insurance and other forms of precautionary investment are quite ubiquitous in developed country households.

Generally, developing countries (such as South Africa) are quite different as they are often hit by severe idiosyncratic shocks (i.e. household-level shocks such as death, injury or unemployment) and covariate shocks (i.e. community shocks, such as natural disasters) (Günther & Harttgen, 2006). Income and consumption volatilities, thus, might be higher with often far-reaching effects. Job losses and health-related shocks are much more frequent in contexts like South Africa. Many big families rely on a single income source – usually a single working member of the household – and if such a member should get incapacitated or (worse) die, the family might be left completely destitute. What is worse is that fewer people are insured against these shocks, so when they hit, earnings are likely to plummet for an extended period – with enormous effects on consumption. Collins and Leibbrandt (2007) note, for example, that the key impacts of death on South African households are funerals and the loss of income as

funerals often cost up to seven months of income. Although many households attempt to cover such costs by holding a portfolio of funeral insurance, 61 per cent were found to be underinsured against the cost of a funeral.

There are, of course, certain shocks that affect households in developed countries but which might have very little to no effect on households in South Africa. For example, fewer people in South Africa are directly affected by changes in interest rates, happenings on the stock market or abrupt changes in house prices as in developed countries. For example, in the U.S., housing price shocks have been reported to even trigger divorces (Farnham, Schmidt & Sevak, 2011; Milosch, 2013).

Most of the literatures reviewed in this study, however, seem to suggest that shocks are important in the economic lives of households in developed countries possibly as much as they are in developing countries. For instance, it is possible that the huge income inequalities in many of the developed countries will see some households unable to insure themselves appropriately. For example, a study by Lusardi et al. (2010) brings this to light. The study investigated U.S. households' risk exposure and risk-bearing capacity and found that many families judged themselves financially vulnerable and almost half of Americans felt that they were unlikely to access US\$2000 in 30 days in the event of an emergency.

Like in most of these literatures (e.g., Getter, 2003; Avery et al., 2004; Grant, 2010, etc.), the current study defines a shock as a 'surprise' relative to 'expectation' or as merely negative situational changes (Bikker & Metzmakers, 2005; Pesola, 2007). This is so, according to Pesola (2007), because the plans of economic agents are based on the current state of affairs, the economic outlook and expectations and, therefore, any deviations from this state of affairs will affect the agents' economic plans. Given the data limitations, the severity of the shock has not been taken into account, but whether there was a change in the state of affairs and whether the agent's subsequent financial performance can be traced to that change or not (e.g., experiencing a job loss, regardless of the length of time it took to find another).

In summation, if consumers plan ahead based on available and expected resources, any event that negatively affects these resources – regardless of the severity – might force them to deviate from their plans, at least in the short term. Nevertheless, it needs to be noted that households in developing countries might be more vulnerable to shocks given the lower socio-economic development and the chronic absence of viable insurance.

5.3 The methodology

Household data from the 2002, 2005 and 2006 Waves of the Cape Area Panel Study (CAPS) were used in this present analysis to examine consumer debt delinquency in South Africa (a description of the CAPS is presented in Chapter 3). The CAPS household questionnaire collected information on household income, expenditure and debt, adverse shocks as well as other household characteristics. Information regarding the size of the household is contained in the household register.

In the survey, consumer delinquency is defined by the following variable:

In the last 12 months, has there been a time when anyone in this household was buying something on credit, including credit cards, hire purchase, store cards, charge cards or lay-buy, but could not make the payment?

A household is considered to be delinquent in respect of their consumer (non-mortgage) debt if the respondent answered yes to the above question. Presumably the questionnaire respondent understood this question to refer to all consumer credit obligations, including cash loans and other consumer debts not mentioned and excluding any housing debt. Unfortunately, it needs to be acknowledged that such a question can only gather very limited information as to the nature and severity of the household's repayment problem and therefore, these aspects cannot be investigated here. It is not possible to tell how long the household had been in arrears (i.e., the seriousness of the risk) and whether the non-payment was transitory or a complete default.

Some studies (e.g., Getter, 2003) have been able to analyse the seriousness of the default risk depending on duration of the delinquency such that the risk of default increases with number of payments missed. The current study, however, should be seen in the same context as the observation by Grant (2009), that delinquency covers a wide range of different borrower behaviours: from bankruptcy at one extreme to being a few weeks behind on some payments at the other. Whatever the case, lenders typically view late payment as a risk of default and as long as a respondent answered 'yes' to the above question, default risk can be assumed, hence the terms 'delinquency' and 'non-payment (arrears)' are used interchangeably to infer default risk.

The variables depicting changes in household circumstances over time are derived from observable differences in the reported situations between different waves and the self-reported changes in household situations. The financially adverse events (proxies for shock) are those

circumstances presumed to increase claims on family resources, and/or the potential to adversely affect household income streams or expenditure during the 2006 Wave of the CAPS. These include a decrease in income, increases in expenditure and family size, self-reported random negative events such as a death or illness, and the subjective measure of financial pressure (where respondents were asked to judge their household's financial situation at the time of the survey as either very comfortable, comfortable, just getting by, poor or very poor).¹⁰⁸ While it is possible that some households may have been able to anticipate such changes,¹⁰⁹ those were the best questions available in the CAPS representing changes that might be beyond the lenders' and debtors' control at the time a credit agreement was concluded.

Because there is no information on the amounts of debt consumed, the variable depicting excessive consumption was adopted from the households' total expenditure and measured as the ratio of the household's total monthly expenditure to the household's gross monthly income (expenses-to-income). Expenses-to-income ratio represents the standard level of the household's expenditure on commodities and services. This variable has been used by Kennedy, Delany and Mac Namee (2011) – on Irish households – in a simulation exercise of credit risk in scenarios where legal requirements and commercial sensitivities prevent the sharing of enough data. They find that the greater the expenses-to-income ratio the higher the risk of default. Also in Saunders and Hill (2008) – on Australian households – who note that where the expenses-to-income ratio is very high, it raises doubts about relying on income alone to indicate the current living standard of the household. Just as in Kennedy et al. (2011), mortgage repayments and housing rental charges were not included in the measurement of the expenses-to-income variable. This was intended to minimise the differences between those consumers that have recently entered the housing market and those that have been in the market for a considerable time.

Household monthly per-capita income, financial buffers and homeownership were included in the analysis as measures of ability to borrow in order to account for the importance of lenders' selection criteria such that a negative sign on these variables should be intuitive. The financial buffers available in the data are quite modest but are assumed to provide some protection from risk, for instance in the event of a death, a household may draw down savings or use the life

¹⁰⁸ 'How would this household classify its overall financial situation these days? Would you say it is very comfortable, comfortable, just getting by, poor, or very poor?' (Financial pressure).

¹⁰⁹ For example, a family may have been able to anticipate that their 2006 expenditure will be higher than that of 2005 or that there will be more dependents in 2006 compared with 2005.

insurance policy instead of having to borrow. The financial buffers used are: having a savings account (assuming households indeed use these to save some of the incomes) and having life insurance. It should be noted that, in South Africa, access to a bank account or life insurance are far from ubiquitous and, even with recent market expansions, having one is still a sign that the holder has a minimum income level – with all the related economic benefits. For example, a recent survey indicated that only 49 per cent of South Africans had a bank account (Gallup Surveys, 2009). In terms of socio-economic effects of having a bank account or life insurance, most credit checks often involve bank statements while anecdotal evidence suggests a common practise of borrowing against debtors' insurance policies. Thus assuming all else is equal, households holding these assets will be in a better position to cultivate mutually beneficial relationships with lenders.

The survey revealed that 21 per cent of respondents who answered the household questionnaire in 2002 indicated that they were delinquent in respect of their consumer debts while 23 per cent reported being delinquent in 2005, and 18 per cent reported delinquencies in 2006. To avoid possible biases that may result from attrition (of households), only those on which information was successfully collected in all the three waves (i.e., 2002, 2005 and 2006) are included in the analysis ($N=2549$). Table 9 below presents the definition of the variables of interest and their mean values for this subsample. The mean value of the default risk variable was 0.18 in 2006, thus 18 per cent of the sub-sample reported being delinquent on their consumer debts. The average household size was 4.2 and 4.8 in 2002 and 2006 respectively, while 50 per cent of households increased in size between the two periods.

With regard to changes in income, 53 per cent (1342) of the 2549 households reported a decrease in income between 2002 and 2005. Sixty-six per cent reported an increase in the general household expenditure between 2005 and 2006 and 19 per cent reported a negative event that may have had an impact on the family's financial situation (such as death of a family member or loss of a major income source) in 2006. The mean value for the financial buffers variable was .79 (i.e., life insurance or bank account, or both). Fifty-one per cent of the subsample reported having access to at least one of the financial buffers (either a bank account or life insurance) and 28 per cent reported both life insurance and a bank account. Seventy-four per cent (1861) of the subsample owned their primary residences in 2006.

Table 9. Variable definition, sample mean values and expected signs

Variable	Mean values	Description
Default risk	0.18	Binary variable (0/1): 1 if a household fell behind on debt payments in the 12 months preceding the 2006 survey, 0 otherwise. (Dependent variable)
Measure of excessive consumption		
Expenses-to-income	0.65	Continuous; Total household expenditure in 2005 divided by total income in 2005 (between the 1st and 99th percentiles) [max .11 – min 3.1] (+).
Sources of shock		
Family size▲	0.50	Increase in family size (continuous variables of a household's 2002 and 2006 family sizes compared). Dummy: 1 if the household had more members in 2006 compared to 2002, 0 otherwise (+).
Income▼	0.53	Decrease in income (continuous variables of a household's 2002 and 2005 net income compared). Dummy: 1 if 2005 income is less, 0 otherwise (+).
Expenditure▲	0.66	Increase in expenditure (continuous variables of a household's 2005 and 2006 total expenditure compared). Dummy: 1 if the 2006 expenditure is greater than 2005 expenditure, 0 otherwise (+).
Negative events	0.19	Self-reported - Dummy: 1 if household faced at least one of the negative events that may have had an impact on the financial situation or living conditions in the year prior to the 2006 survey, 0 if none faced (+).
Financial pressure	0.67	Self-reported. Dummy: how respondent considers the family's 2006 general financial situation to be (1= poor/very poor, 0= otherwise) (+).
Dependents	0.66	Households with dependent children. Dummy: 1 if household had members less than 18 year old in 2006, 0 otherwise (+).
Ability to borrow proxies		
Per- capita income	R5, 791	Continuous: Household per-capita income after deductions in 2005; [min R45 – max R 20, 000] (-).
Financial buffers	0.79	Continuous: If household had, life insurance, bank account, both of these together or none of them in 2006 (-).
Homeownership	0.74	Dummy: 1 if family owns the primary residence in 2006; 0 otherwise 0 (-).

Descriptive statistics were examined for each variable of interest and presented in the table below. Chi-square measures of association were analysed between the household characteristics and the binary dependent variable ‘default risk’. The distribution of characteristics among the delinquent and non-delinquent households is presented as mean values, whilst bivariate correlation coefficients are also presented for the measures of the strength of the relationship between the default risk variable and the individual independent variables. A statistically significant p value ($p < 0.05$) means that one of categories of the variable depicting household characteristics is statistically significantly different from one of the categories of the dependent variable. These tests revealed the first signs of association between those household characteristics and the dependent variable.

Table 10. Descriptive statistics of key variables for delinquent and non-delinquent sample (N = 2549).

Variables	Distribution of delinquent and non-delinquent households		Corr	P*
	Non-delinquent	Delinquent		
	Mean	Mean		
Excessive consumption				
Expenses-to-income	0.64	0.65	0.003	.900
Sources of shock				
Family size▲	0.49	0.55	0.052	.009
Income▼	0.51	0.58	0.055	.006
Expenditure▲	0.65	0.73	0.061	.003
Negative events	0.19	0.23	0.039	.049
Financial pressure	0.66	0.72	0.052	.009
Dependents	0.64	0.75	0.091	.000
Ability to borrow related factors				
Homeownership	0.76	0.64	-0.106	.000
Per capita income (2005)	R1, 460	R1, 336	-0.022	.268
Financial buffers	0.63	0.64	0.003	.857

Notes: Corr refers to bivariate correlation coefficients; P* Refers to chi-square test for significance.

The two possible reasons for a household's inability to repay its financial obligations as or when due are: (1) either it overspent on household needs and found itself financially overstretched or, (2) it experienced some financially adverse events and lost the capacity to repay even where it might have been spending relatively moderately in relation to its incomes.

Households that have experienced an adverse event may be less able or less willing to repay their debts on time. For example, after an unexpected fall in income, a household may find that they are unable to repay a loan that would otherwise have been affordable. Sometimes the debt could still be affordable, but the family may realise that it risks facing substantial hardship if it makes an immediate repayment, and may consider it a good reason to postpone or delay repayment. Households' behaviours can also be unpredictable if they expect a change in income. For instance, a household expecting a reduction in future income may decide to default now as a way of preparing for the impending shock especially, if it believes that the creditor is unlikely to pursue repayment or if the sanctions for defaulting are relatively lighter compared with having to sacrifice that income. Additionally, a household could increase current borrowing, if it gets an inflated future income expectation and may end up defaulting if the results fall short of expectation. Unfortunately, the data cannot distinguish whether the shock was fully anticipated or not. It is also not possible to determine with certainty whether the financially adverse event or the overspending solely led to arrears. It is possible that both factors complement each other (e.g., unreasonable spending preceding the adverse event).

Instead, this study investigates whether a household becomes delinquent following a financially adverse event or a period of excessive spending relative to income.

Following Getter (2003) – on American households – this study anticipates that if the credit market was behaving rationally, then delinquencies would be most likely to occur as a results unfortunate circumstances. If this were so, the level of consumption expenditure and the borrowers' economic characteristics such as current income and asset would be negatively related to delinquency or not related at all. The reason for this is that responsible lenders would have already observed these variables before granting credit and, therefore, would not matter *ex-post*. If delinquencies are most likely to result from excessive spending, however, it might suggest a possible relationship with poor lending and/or borrowing behaviours which allow consumers to over-extend themselves.

The bivariate relationships in the table above provide no support for the importance of excessive spending in debt repayment performance, as delinquent and non-delinquent households are not statistically different with regards to the expenses-to-income ratio variable. These bivariate relationships, however, show that households are more likely to miss repayments if they faced adverse circumstances that might have harmed their incomes and as expected, a positive relationship can be observed on all variables selected to represent financially adverse events (i.e., increase in household size between 2002 and 2006; decrease in income between 2002 and 2005; increase in expenditure between 2005 and 2006, and having dependent children in 2006). Twenty-three per cent of the delinquent households reported that they experienced a random negative event in the twelve months prior to the 2006 survey compared with 19 per cent of the non-delinquent households who reported experiencing such an event. This is statistically significant. A significant positive correlation is observed between self-reported financial pressure and consumer debt repayment problems ($p=0.01$), with 72 per cent percent of the delinquent households self-reporting that they felt financially stressed in 2006 and 66 per cent of non-delinquent households self-reporting a feeling of financial stress.

The importance of the lenders' selection criteria is inconclusive with significant differences between delinquent and non-delinquent households observed only for homeowners. Sixty-four per cent of delinquent households were homeowners compared to 76 per cent of non-delinquent households who were homeowners, and statistically different ($p=0.000$). Intuitively, just as homeownership might contribute positively to households' credit ratings, homeowners are also less likely to be delinquent on their consumer debts. In the case of household per capita income,

no statistically significant difference was observed between delinquent and non-delinquent households (the average income per capita for delinquent households was R1,337, just marginally lower than that for non-delinquent households at R1,460) but the expected negative relationship is observed. Also, no statistically significant difference was observed between delinquent and non-delinquent households with regards to ownership of financial buffers.

Overall, according to the bivariate results, the relationship between consumer debt delinquency and excessive spending cannot be verified. The first signs thus seem to suggest that household arrears occur, not because households over-extend themselves by consuming excessively relative to their incomes or because they act ‘strategically’ by (knowingly) consuming more than they can repay, but due to unfortunate circumstances that might have eroded their capacities to repay, even when they might not have overextended themselves or even if the debts might have been affordable.

5.4 Binary logistic regression models

What matters most for borrower delinquencies: excessive consumption that renders a borrower financially over-stretched or financially adverse situations and unforeseen negative income shocks that erode repayment capacity? Binary dependent variable logistic regression models were estimated such that a household’s current default risk is evaluated based on its circumstances and actions in the preceding period while allowing for the fact that some households are more likely to pay their due debts (timely) than others. More precisely, the dependent variable in the default risk model is debt delinquency captured in the 2006 wave of the CAPS survey. The predictors are the variables depicting household shocks and excessive spending informed from household situational factors captured in the 2002 and 2005 waves, and some observable changes in these factors between the waves. Three covariates (homeownership, financial buffers, and per capita income) are also included to control for lender selection (ability to borrow).

The logistic regression models for default risk in 2006 are presented in Table 11, below. A multivariate default risk model combining the measures of excessive consumption and financially adverse events is first estimated. Then the model is estimated, controlling for the three measures of a household’s ability to borrow (i.e., homeownership, per-capita income and financial buffers). Finally, the third and fourth columns represent split sample models. Column three is the model conditional on household income increasing or remaining stable and the model in column four is conditional on a household experiencing a decrease in income – while

controlling for ability to borrow. A statistically significant relationship between a predictor and the dependent variable is assumed to represent either an increase or decrease in the default risk of a household. A negative sign represents a decrease in the probability of delinquency and thus a decrease in the default risk and a positive sign represents an increase in the probability of delinquency, hence an increase in the default risk.

Some of the results obtained are not consistent with those from other countries where consumer debt delinquencies have been studied. This inconsistency is then attributed either to the socio-economic and institutional differences between countries or the state of the South African credit market at the time (which, as was widely suggested, was inadequately regulated with reported widespread arbitrary standards of credit allocation and fragmentation), but could also be attributed to the data used as the CAPS was not designed to be a pure income and expenditure survey.

5.4.1 Economic and demographic shocks

The logistic regression results (coefficients and their robust standard errors) for economic and demographic shocks appear in the table below. The variables used to analyse the direct effect of financially adverse events on delinquency are: a decrease in household income; an increase in expenditure and increase in family size; random negative events (e.g., experiencing a death, illness or loss of a major income source, etc.); and subjective economic pressure (financial pressure). These variables can capture some of the adverse changes in family circumstances that often disrupt families' income streams, thereby eroding their ability to continue meeting debt repayment obligations. Furthermore, although 'having dependent children' cannot be considered as a shock (which it should have been if it were a case of a new-born baby), it might suggest extra claims on family resources but more importantly, higher exposure to risk.

Although it is not possible to ascertain this from the data, some of the variables analysed for this part are able to capture changes in economic circumstances occurring after a credit request has been granted and might not have been anticipated by both the lender and borrower at the time the delinquent credit agreement was made. As such, lenders were unlikely to control for these in their credit scoring systems and when they do happen, debtors are likely to divert resources earmarked for an installment payment to cater for the resultant costs. In others cases, where the shock might have been anticipated (e.g., end to a job contract), the debtor may also plan ahead and choose to miss some payments if he fears the worst.

Getter (2003) has shown in data from the U.S.A that having an income lower than usual significantly increases the likelihood of delinquency even were households had accumulated some precautionary wealth. The results in the current study suggest that households which experienced a reduction in income between 2002 and 2005 were more likely to be delinquent than those whose incomes increased or remained stable, even when controlling for ability to borrow.

Increase in expenditure and increase in family size – both of which might represent a strain on family resources – were also consistently significantly positive determinants of default risk. The positive signs on the coefficients of both variables were intuitive, implying that families that experienced these scenarios might have faced budgeting troubles and thus become less able to stick to their repayment plans than those who did not experience such changes – even when controlling for their *ex ante* ability to borrow. These results confirm previous empirical evidence reported in Filotto and Nicolini (2010) for Italian households. While these two variables may capture the effects of an expenditure shock on families' ability to pay financial obligations, the Variance Information Factor (VIF) test did not detect any hint of multicollinearity between the two variables as well as between other predictors.

In all specifications, households who self-reported experiencing a random negative shock (like a death or illness) were more likely to be in arrears than families which did not. Other factors being constant, random negative events which might impact negatively on a family's financial situation, significantly increase the likelihood that it will not be able to repay its financial obligations when due. For example, a death or serious illness of a family member might result in unanticipated expenses which could disrupt the family's budget to such an extent that the family may no longer be in a position to satisfy some of its immediate financial obligations or may have to divert resources earmarked for debt repayment in order to cater for the new expenses that might have resulted from the event. Collins and Leibbrandt (2007) have noted that, although precautionary savings are always helpful, some required expenses resulting from these unfortunate events are often too big so that the saving instruments are often not feasible in meeting the entire cost of such events as a funeral.

Table 11. Default risk logistic models for income shock and excessive spending

Results of the logistic regression analysis for shock and excessive spending				
Dependent variable: Delinquent = 1 Non-delinquent = 0				
		With ability to borrow proxies	Income increased /stable	Income decreased
Socio-economic shocks				
Income ▼	0.01** (0.01)	0.02** (0.01)		
Expenditure ▲	0.34*** (0.13)	0.43*** (0.14)	0.37* (0.20)	0.59*** (0.21)
Family size ▲	0.25** (0.11)	0.22* (0.11)	0.30* (0.17)	0.18 (0.15)
Financial pressure	0.30** (0.13)	0.30** (0.13)	0.23 (0.20)	0.30* (0.17)
Negative events	0.31** (0.13)	0.36*** (0.14)	0.73*** (0.20)	0.04 (0.18)
Dependents	0.49*** (0.13)	0.44*** (0.13)	0.39** (0.20)	0.48*** (0.17)
Expenses-to-income ratio				
Quintile 2	-0.40** (0.18)	-0.39** (0.18)	-0.39 (0.26)	-0.40 (0.25)
Quintile 3	-0.31* (0.17)	-0.33* (0.18)	-0.43 (0.27)	-0.22 (0.25)
Quintile 4	-0.01 (0.17)	-0.02 (0.17)	0.01 (0.26)	-0.01 (0.23)
Quintile 5	-0.21 (0.17)	-0.22 (0.18)	-0.20 (0.30)	-0.11 (0.23)
Ability to borrow				
Per-capita income		-0.00 (0.00)	-0.00 (0.00)	0.00 (0.00)
Financial buffers		0.25 (0.16)	0.22 (0.28)	0.18 (0.20)
Homeownership		-0.62*** (0.12)	-0.45** (0.19)	-0.72*** (0.15)
Intercept	-2.36*** (0.21)	-2.07*** (0.27)	-2.21*** (0.44)	-2.08*** (0.37)
N	2,316	2,282	1,076	1,206
Log likelihood	-1063.10	-1031.10	-443.11	-583.39
AIC	2148.20	2092.00	912.23	1193.00
BIC	2211.42	2172.21	977.00	1259.03
Pseudo R ²	0.029	0.044	0.046	0.044

Note: Robust standard errors in parentheses, **AIC** and **BIC** refer to: Akaike information criterion and Bayesian information criterion for measure of the relative goodness of fit*** p<0.01, ** p<0.05, * p<0.10.

Random unanticipated shocks may trigger repayment difficulties, even for financially astute consumers, including those with some precautionary assets or insurance. It is useful to note that due to the short-term maturity of consumer debt, conventional insurance might not help. A family might find it hard to sell off its realisable assets to cater for the immediate financial obligations, while insurance pay-outs may be delayed for weeks and sometime months or years. Random events may also increase the level of indebtedness as some families might be forced to borrow more to make up for the deficit, a decision that may subsequently worsen their financial performances even further. While keeping the objective measures of economic

pressure constant (including excessive expenditure), subjective economic pressure (financial pressure) was also found to be a significantly positive predictor of default risk, even when the household's ability to borrow has been controlled for. Families that reported feeling financially strained were more like to be delinquent than those that did not. For this result, it is not possible to judge whether the feeling of financial pressure is a result of the family's inability to cater for current and impending financial obligations or they are unable to maintain payments because they feel financially insecure and then they realise that paying the installment might cause further undue strain on family wellbeing. Nonetheless, a positive relationship between subjective economic insecurity and consumer debt delinquency is observed. Financial insecurity has a tendency to cause households to behave unpredictably in attempts to smooth consumption during the period of insecurity. They could simply abandon their financial obligations, or borrow more even when they are unsure of their repayment capacity subsequently.

Having dependent children was found to be highly significant, and positively related to consumer debt delinquency. Holding other measures of shock and excessive spending constant, the predicted probability of experiencing consumer debt repayment problems was 0.20 if the household had dependent children and 0.14 if the households did not. Similar findings are observed for consumer debt repayment performances in EU households by Grant (2009), mortgage debt repayments in Britain (May & Tudela, 2005) and satisfying consumer bankruptcy repayment plans in the U.S. (Evans & Lown, 2008).¹¹⁰ In all these cases, families with dependent children had higher probabilities of repayment difficulties than those that did not. For this finding, Grant (2009) suggested that such a relationship can be explained by the fact that meeting debt obligations may be a lower priority than spending on children when the household needs to prioritise resources in the short run. It is also more likely that households with dependent children will have a higher propensity for recurrent unanticipated, yet inevitable, expenses which might interfere with their ability to commit to the repayment plans in place.

¹¹⁰ In the United States, under the U.S. personal bankruptcy law, Chapter 13 bankruptcy petitions enable individuals with regular income who file for bankruptcy to develop a plan to repay all or part of their debts. Under this chapter, debtors propose a repayment plan (Chapter 13 repayment plan) to make installments to creditors over three to five years. An empirical study by Evans & Lown (2008) found that having dependent children negatively affected completion of Chapter 13 repayment plans so that – controlling for other household economic and demographic characteristics – dependent children increased the odds of dismissal of Chapter 13 bankruptcy filers due to non-payment by nearly 50%.

In logistic regression models conditional on a household experiencing a decline in income and the income remaining constant or increasing, the positive relationships between delinquency and financially adverse events does not change. The strength of the relationship, however, is highly attenuated for increase in expenditure, increase in family size ($p < 0.10$) and having dependent children ($p < 0.05$) in the model conditional on incomes increasing or remaining stable. This might mean that if household incomes are increasing or remain stable the effects of shocks (although still negative) may not be so severe on household's repayment performance. Conversely, the strength of the relationship between consumer debt delinquency and experiencing random negative events greatly increases for households whose incomes did not decrease, which could be interpreted to mean that when a household experiences unanticipated random shocks the probability of being delinquent will remain high, even when its income increases or remains stable. This is possibly so because the household might choose to postpone the debt repayment in order to maintain its required level of consumption. For households which experienced a decrease in income, the default risk was found to be higher if they experienced increases in general household expenditures or if they had dependent children. Perhaps this increase in the strengths of the relationship is related to the extra borrowing that the households might have undertaken in order to plug the decrease in income and the perceived higher consumption need resulting from having dependent children. Increase in family size is only significant for households whose income increased or remained stable while subjective financial pressure is only significant for households who experienced income decrease. This might mean that the decrease in income might have had a direct linkage with the households' self-reported feelings of financial strain.

Performing separate analyses for households that experienced negative income shock and those that did not, makes it possible to evaluate the importance of household income stability in the repayment capacity of household. As noted earlier, the cash flow theory posits that as long as income is sufficient to cover current debts without undue pressure, delinquencies will be less likely to occur. The findings here suggest that even when the income increases or remains stable, the extra financial responsibilities that might result from an emergency might still be binding enough to negatively affect the household's repayment performance – even though in some cases the non-payment might be transitory to allow the family to recover. The reduction in the strength of the relationship for some variables might in contrast mean, perhaps, that the decrease in income may have forced some families to make extra sacrifices. Anticipating tougher times ahead, households might decide to reduce their indebtedness levels to avoid

being blacklisted and being unable to qualify for future credit. Borrowing constraints might also prevent households from getting over-burdened. In addition, households whose income increases or remains stable might be less cautious with their spending habits and may consume more than those whose income dropped, thereby allowing themselves to get over-extended.

The results for socio-economic shock support the hypothesis that, even when households borrow within their means, there is still a big possibility that they will experience repayment difficulties if they experience a negative economic or demographic shock which disrupts their cash flows. These findings underpin the importance of household situational factors, or interruptions thereof, in the overall financial performance of the household sector. The findings also suggest that credit history and current resources – although possibly useful – might not be enough to warn lenders of potentially bad credit risk. In the same vein, Avery et al. (2004) argue that although credit history scores offer benefits to lenders and borrowers, these scoring systems might not accurately quantify an individual's credit risk unless the individual's situational circumstances are considered. As such, all debt has a potential to go bad due to the inability to control for unanticipated adverse changes especially if these happen post-consumption. While the results here do not dispute the fact that abusive market behaviours were rife during the period of interest, and that many consumers were possibly experiencing repayment problems because of poor credit practices, these results are a clear indication that there were other (possibly more) important forces at play. The results suggest that many South Africans were failing to keep up with their financial obligations due to unfortunate events beyond their' and lenders' control – even when they borrowed responsibly and/or even where credit went only to those who had the visible means afford it. These findings are sensible given the fact that household shocks are very frequent in South Africa and are likely to cause binding income and consumption volatilities due to the chronic absence of viable insurance. This could be an indictment of the studies that informed the designers of the NCA, notably, the 'a policy framework for consumer credit' document for failing to acknowledge the importance of shocks in the debt problems of South African households.

5.4.2 Excessive consumption and default risk

Are households' more likely to experience debt repayment problems due to excessive spending? The household's monthly expenses-to-income ratio – which was used as the measure for excessive consumption – was divided into quintiles to test whether households at the upper tail of the distribution of the expenses-to-income ratio are more likely to experience higher

rates of repayment difficulty than those with a lower ratio. The results of the logistic regression analysis indicate that, while keeping constant the proxies of shock, the probability of experiencing debt repayment difficulties is likely to be lower for households at the lower end of the distribution of the expenses-to-income ratio (quintile 2 and 3). This remains the case even when controlling for households' ability to borrow. In this case though, the strength of the relationship is lower. The relationship between delinquency and the expenses-to-income ratio was not statistically significant at the upper end of the distribution of the variable (quintiles 4 and 5). In the split sample analyses (i.e., income declined and income increased/stable), no significant relationship was observed at all the quintiles of expenses-to-income. These results provide no evidence that delinquencies increase due to excessive consumption.

One possible interpretation for this result could be that, because credit providers are able to observe the households' level of expenditure before accepting a credit request, a higher expenses-to-income ratio might not mean that the household will struggle to repay but rather might be a reflection of the household's ability to borrow. So, if lenders are able to appropriately detect and eliminate bad risk, the good payers should be able to hold high ratios of expenditure-to-income (subject to the credit limit) without going into arrears. Contrariwise, in the absence of viable risk assessment mechanisms, lenders will not be able to eliminate bad risk, such that delinquencies will be more likely to result from excessive consumption. The other scenario is related to the market in general. Faced with consumption pressures, consumers will attempt to borrow regardless of whether they have the means to do so or not. The onus is on the lenders to determine ways of eliminating those without the means from those with the means, if they are to protect themselves against default losses. This also supports the conclusion in chapter 3 that even though the market was under regulated, creditworthiness was still the biggest determinant of lending.

It is also possible that excessive consumption does not matter for consumer default risk, since many households will choose not to take on more obligations once they feel that their finances are getting overstretched by current obligations. Considering the high propensity to underreport expenses – the numerator of expenses-to income ratio – caution is however also necessary when reading into these results. Many respondents cannot be expected to keep accurate records of all their expenses in a month. In which case, a diary survey might be better suited to address the question on expenditure.

5.4.3 The control variables

While controlling for a households' ability to borrow, the aim was to establish whether household debt delinquencies are better explained by financially adverse events that erode repayment capacity or by excessive consumption that leads to a financial strain. The ability to borrow is tantamount to creditworthiness. This is what lenders consider in their risk assessment exercises and, therefore, controlling for households' ability to borrow allows for the fact that some households are more likely to pay their debts promptly than others. It has been noted earlier that it should not matter whether households consume excessively if lenders apply optimum risk evaluation measures because consumers will only qualify for the maximum amounts they are able to repay and any subsequent delinquencies will only result from external factors. Thus, it was assumed that the proxies for ability to borrow would have a negative relationship with delinquency. This would render the level of consumption either insignificant or negatively related to delinquency, but would have no big effect on the relationship between delinquency and shock. The results spoke accordingly.

Income and income-related variables (i.e., per-capita income, ownership of financial buffers and homeownership) were used to control for households' ability to borrow. Keeping a household's credit history and other economic attributes constant, positive values of these variables should be interpreted by lenders to represent good credit risk. When these controls were introduced in the default risk model only a very slight increase in the standard errors of the variables depicting shock and excessive consumption was observed, with no changes observed in the relationship between the main variables of interest and the dependent variable. Also, the significance levels of the main variables of interest remain constant with the exception of increase in family size whose significance weakens ($p < 0.10$).

In the default risk models, per-capita income and financial buffers were consistently insignificant. Again, this result could be interpreted to mean that because lenders are able to observe these factors before granting credit, such factors may not matter *ex-post* (after the credit request has been granted).

While homeownership was the best available indicator of physical asset holding that can control for the potential impact of family stability on credit participation, it is a rather weak indicator in the South African context. The reason for this is that presently many poor households – including those without regular incomes – own their homes as a result of the government's Reconstruction and Development Programme (RDP), while many relatively

higher-income people are renters. Homeownership is, nevertheless, positively correlated with income and highly significant ($p=0.000$) in both 2002 and 2005 (the only waves where both variables are available).

Homeownership was, as expected, negatively associated with default risk and highly significant in all specifications. This suggests that – holding the presence of financially adverse events and excessive spending constant – homeowners were more likely to commit to their debt repayment obligations compared with those who were not. In terms of family stability, this result might be sensible after all, given that homeowners are more likely to make greater sacrifices to repay their obligations than becoming non-contactable when faced with undue financial stress. The same results were observed even where a household experienced negative incomes or where the income increased or remained stable. Similar results have been noted from the U.S. (e.g., Getter, 2003 and Agarwal et al., 2003) and European data by Grant (2009).

In this study, whether the household was delinquent in respect of consumer debt repayment is the outcome variable, and financially adverse events and excessive spending (informed by the household's general expenses-to-income ratio) are the focal independent variables. In effect, this chapter examined the relationship between variables relevant to a household's cash flow problems (resulting from either a negative shock or an expenditure burden) and whether this cash flow problem results in the household not fulfilling its due financial obligations. The results indicate that shocks to income and expenditure are more important to the household's repayment performance than excessive consumptions – even where (for some other reasons) some households are more like to repay their debts than others (creditworthiness). This suggests that in the presence of economic or demographic shocks to a household, the level of resources at the time of entering the credit contract might not be very informative with regards to who is more likely to be delinquent. In other words, even where lenders apply good risk assessment measures and lend only to consumers with the 'visible' ability to repay, delinquencies will still occur due to the possible changes in debtors' circumstances following the credit grant.

To be precise, the households in the sample analysed here were more likely to be delinquent on their consumer debt obligations when they faced one or more of the financially adverse events such as a reduction in income; a random negative event such as a job loss, illness or divorce; consumption pressure resulting from increase in family size; and having dependent children. Households were also more likely to be delinquent if they subjectively felt financial

pressure. The households' level of consumption expenditure (measured in terms of expenses-to-income ratios), was not found to be as relevant as theory postulates.

In addition, results of a triangulation exercise using macro-economic effects ([Appendix B](#)) underpin the importance of shocks in the financial health of the household sector. When a selection of macro-economic effects were tested against the impairment losses of two major banks, the results also indicated that exogenous shocks over which households have little or no control will have a similar effect on their debt repayment performance as do the household-level shocks.

In general, the importance of household specific shocks means that traditional risk assessment measures and regulatory tools to prevent over-indebtedness cannot be enough to eradicate the problem of consumer over-indebtedness and defaulting on financial obligations. Because many South African households might not have insured themselves sufficiently, and the chronic lack of savings, households' currently observed income status might not be a sufficient indicator of their future default risk. Thus consumer protection efforts especially where households, are vulnerable to idiosyncratic shocks which result in profound income volatilities, might need to look beyond 'preventive' solutions to consumer debt problems.

5.5 Conclusion and Implications

This study provides an empirical analysis of the consumer debt repayment performance of South African households, a field that has been rejuvenated with the passage of the new credit market regulations. Most narrowly, it sheds light on why some consumers faced difficulties fulfilling their financial obligations, and most importantly, based on the empirical findings, the study aimed to provide an understanding of what areas of the credit legislation might need further attention.

Based on the cash-flow theory of default, the study investigated whether consumer debt repayment difficulties were more likely to result from financially adverse events which erode the household's capacity to keep up with monthly repayments or as a result of excessive spending (measured as the household's expenses-to-income ratio) which renders households financially overextended. To allow for the fact that some households are more like to repay than others, the study controls for a few variables that proxy for a household's 'ability to borrow'. As has been observed in the literature, ability to borrow varies across households, and

by using income and income-related variables, lenders are able to choose which households are more likely to repay than others (creditworthy).

This pre-selection exercise eliminates habitually bad debtors (if ever there were any), so that only those with good intentions are accommodated and therefore subsequent repayment difficulties will not result from how much they consume but rather from (post-consumption) changes in their situations that might adversely affect their cash-flows. The results of this analysis suggest that consumer-debt delinquencies (during the period of interest) were more likely to result from financially adverse events and less likely to result from excessive spending. These results are consistent with the cash flow theory of default. The results are also consistent with a number of empirical studies from the financially developed world (e.g., Getter, 2003; Avery et al., 2004 for the U.S.) and Bridges and Disney (2004), Grant (2010) and Rinaldi & Sanchis-Arellano, (2006) for Europe.

Other similar studies (e.g., Whitley et al., 2004; Tudela & Young, 2005; Mian & Sufi, 2010) attribute some importance to excessive spending as well, but find that delinquencies are more likely to occur as over-leveraged households are confronted by unanticipated negative changes in income. It has also been noted however, that economic shocks are likely to affect different households in different ways due to the variances in the distribution assets and levels of income (e.g., Tudela & Young, 2005; Krueger & Perri, 2009). This means that the more vulnerable households (e.g., those with low-labour incomes, higher dependence, single bread-winners or without precautionary savings) will experience the highest probability of stopping repayments if they should encounter a financially adverse event (e.g., Godwin, 1999; Martin & Hill, 2005; Lopes, 2008).

Given the consistency between the results of the current study and those in these literatures, one might be tempted to conclude, firstly, that household shocks are of equal significance in the debt repayment performances of both the South African market and those of financially developed world. Secondly, that the conclusions in chapter 3 – responsible credit practices – might be binding. It was noted that while the market was under regulated, lenders remained risk-averse and seemed to abide by rational lending practices notably, they were more likely to lend to those with the means to repay. Otherwise, repayment problems would be more likely to result from excessive spending. There are, however, a number of caveats that might make such conclusions rather presumptuous.

Perhaps the biggest caveat is the fact that the CAPS survey was not designed to be a typical survey of household finances and therefore could not collect enough information on household income and expenditure, more specifically, did not collect data on the actual levels of indebtedness and repayments. It is thus not possible to investigate whether the actual amount of debt held played a role in the inability to repay. Also, since the focus of the CAPS is on ‘young adults’ living in these households, it is less likely that the economically dominant person in the household (or one more conversant with the household’s financial matters) was always assigned to answer the household questionnaire.

Secondly, it has been suggested¹¹¹ that a dual market was in existence during the period of interest and that the regulatory environment was more effective among higher income earners who mainly borrowed from the formal lenders, at an interest rate limited by the Usury Act, while the lower-income earners were locked in the non-bank and informal sector credit where they borrowed at unregulated exorbitant costs. If the low-income consumers had very limited access to mainstream credit, they would be inherently reluctant to report informal credit activities in the survey, it is then possible that the repayment performance captured by the data is mostly related to the formal credit market where the regulatory environment was more active. If this is true, the results and the inferences thereof should not be surprising then. As such, the existence of wide-ranging irresponsible market practices cannot be dismissed if these were mostly affecting the ‘second’ unregulated market.

The other caveat is related to the unit of analysis used. Given the constitution of ‘households’ in South Africa, one cannot go far when analysing default risk at the household-level. A household-level analysis tends to neglect intra-household inequality and assumes that all resources that enter the household are shared equally by all members, which is not always the case.

Nonetheless, this study provides an important contribution to the literature by submitting that while available resources at the time of accepting a credit request and credit history might be useful in risk assessment exercises, and that regulations on irresponsible lending and borrowing might be useful deterrents to unsustainable borrowing, these might count for very little if lenders cannot control for whether or not debtors will suffer shock after accepting the debt. After a credit request is granted, the consumer’s economic situation at the time of applying for

¹¹¹ In the dti’s policy document that preceded the NCA, the “a policy framework for consumer credit”.

credit (including credit history) will become subordinate to happenings that follow the granting of a credit request.

Consumers may be able to control their consumption and repayment, but whether they will lose their jobs due to an economic slump (or poor health) is largely out of their control. Even where the shock can be anticipated, consumers' behaviours and planning horizons will change and their repayment performances might still suffer. If consumers anticipate that they will suffer a shock in the subsequent period, they are more likely to discontinue or postpone repayments if they realise that making the immediate repayment will leave their families more exposed. In doing so, they are not being dishonest but simply optimising resources.

Given that unexpected changes in consumers' circumstances can result in repayment delinquencies even where appropriate risk evaluation was undertaken, the implications for credit risk evaluation are clear. Lenders need to devise ways to integrate household situational factors in their risk assessment models. They would need to consider other factors that might make some households more sensitive to shock than others, for instance, the level of dependence and the level and type of financial buffering, as these might affect the extent to which households are able to withstand negative swings in income. Further to this, policy measures that encourage household saving should be explored and introduced. Reinstating the requirement for a certain amount of down payment, especially on relatively expensive items, could be one way of encouraging consumers to save.

Further implications for the credit-scoring systems relate to the rejection criteria. The importance of shocks should mean that new entrants to the debt market should possess almost similar risk to that of consumers with established histories. Current risk assessment measures chose or reject applicants simply because they tend to possess similar observable characteristics with past applicants. This means that new entrants will be rejected because they have no records on which to base these comparisons, yet based on their unobservable characteristics some might even be better payers than those with established histories. This point is belaboured, because people attempting to borrow for the first time are often refused credit even by sub-prime lenders and often end up making use of loan sharks.

With regards to the implications for consumer education, traditional consumer-awareness programmes need to be re-evaluated in order to pay attention to the variances in consumers' educational levels. Programmes for those with a certain level of educational attainment should

be designed differently to those targeting consumers without any formal education. Consumer-awareness programmes need to elucidate the value of building sufficient financial buffers (formal or informal), and financial educators need to emphasise the value of keeping a good credit history as this would enable consumers to qualify for low-cost credit whenever needed. In addition to teaching numeracy skills, mainstream academics need to introduce subjects on consumer debt use and personal finance management at the earliest level possible.

These issues bring forth new avenues for research in the area of household financial behaviour and the legislation that regulates it. The variables used in the analysis are drawn mostly from existing literature, so it is noteworthy to investigate why some relationships are inconsistent with those obtained in other countries, while others are consistent with expectations. The differences in context could be one reason, but a further investigation might make interesting discoveries. Moreover, a replication of this study using new data should elucidate the effect of current credit regulatory regime on the repayment performance. Nonetheless, knowledge of the results of the current study can be useful to lenders devising creditworthiness models; policymakers seeking to protect consumers; and consumer educators. These authorities will be able to serve consumers better by increasing their understanding of (and being able to anticipate) which debtors are more likely to face repayment difficulties.

In terms of policy, if excessive consumption was the main driver of debt repayment problems, then restrictions on credit access and other measures to improve responsible market practices (i.e., ‘preventive’ solutions) would have to be revisited. However, the study finds that repayment problems were more likely to result from unfortunate circumstances possibly beyond lenders’ and consumers’ control. This then suggests a need for profound ‘alleviative’ solutions to consumer over-indebtedness because, even where consumers borrow manageable amounts, it is still possible that they will encounter repayment difficulties.

Although it was acknowledged that the measures that were in place (before the NCA) were not up to the task of providing consumers with meaningful relief from over-indebtedness (dti, 2004b:13), the failure to acknowledge the importance of unfortunate events in debtors’ problems might perhaps be the reason why the National Credit Act overemphasised preventive solutions at the expense of tighter alleviative solutions. Although the Act provides for relief and rehabilitation of over-indebtedness under its debt review provisions, these provisions fall far short of modern standards for alleviation of consumer over-indebtedness.

The literature on consumer over-indebtedness suggests that when debtors face misfortunes and later find themselves unable to continue paying their financial obligation, there is a greater possibility that their and their dependents' overall financial situation might deteriorate further if they are left at the mercy of their creditors. Their overall social functioning might also be greatly compromised. It therefore becomes the state's social, moral and practical obligation to offer a helping hand through a legal framework that allows such unfortunate debtors to attempt to repay a portion of the debt on manageable terms (where possible) and then be discharged from the rest – so that they may have a chance at a financial 'fresh start'.

The results of this study, and the fact that household shocks are likely to be more prevalent and severe (often with longer lasting effects) in a developing world context like South Africa, means that such measures are needed in South Africa, perhaps even more than they are needed in the developed world. While the debt review provisions of the NCA were introduced for this purpose, the measures therein are not up to the challenge of providing meaningful relief and rehabilitation to consumers who might need them. There are a number of reasons for this, but most notable is the fact that the NCA does not provide a simple, straightforward mechanism for debt discharge. It is thus submitted that these measures are not good enough and hence, should be reevaluated.

The next chapter (Chapter 6) analyses these measures (i.e., the current regulatory measures for alleviating consumer debt problems) in order to provide an understanding of why these are not up to the task of providing meaningful relief and rehabilitation of over-indebted consumers. This is based on the knowledge that, given the presence of misfortunes, regulating credit access and use might not be enough to eradicate consumer debt problems.

Chapter 6: Relief from over-indebtedness: the need for a fresh start

Abstract

Although the relative risks of consumer over-indebtedness can be identified, and to some extent prevented (e.g., by regulating credit information and disclosure), some consumers will find themselves over-indebted and unable to pay their debts. The presence of shocks such as job losses, illness, divorce or even death means that even families who try to consume responsibly may find themselves suddenly incapable of paying their debts as they fall due, with far-reaching consequences for individual debtors and their dependents. The modern state offers a helping hand to such unfortunate debtors by legislating mechanisms to relieve their debt distress and give debtors the opportunity to reclaim their financial health without punitive action. In a context such as South Africa, where shocks are widespread, often have long-lasting effects and play an important role in the occurrence of consumer debt problems, regulatory debt relief and debtor rehabilitation measures are very important if consumer borrowing is to be sustained. The debt review provisions of NCA provide for consumer debt relief and rehabilitation based ‘on the principle of satisfaction by the consumer of all responsible financial obligations’. This principle prevents meaningful protection to unfortunate consumers. The provisions in the NCA should be revised to provide a simple, straightforward mechanism for debt discharge akin to the American idea of the ‘fresh start’.

Keyword: Consumer insolvency; Consumer bankruptcy; Debt review; Discharge; Fresh start; Over-indebtedness; Relief; Rehabilitation

6.1 Introduction

With debt, rational consumers can successfully shift expenditure from a future period of their lives to the present, just as companies and governments do. It is inevitable that individuals or households will want to hold a certain level of debt from time to time. Although debts are generally repaid, the possibility of default is an inevitable feature of the credit market due, in part, to factors that are sometimes beyond the control of both the consumers and the lenders. When consumers default, lenders may be forced to pursue repayments by instituting litigation measures, seizing collateral (if there is any), or repossessing the goods in question. Alternatively, they may simply write off the debt as a bad risk. Whatever option is chosen, there are unwelcome costs to be borne either by the debtor, creditor, society, or all three. Modern states have recognised this and have devised measures to reduce the effect of such costs by dealing with the underlying debt problems through legal means as far as it is possible without unnecessarily curbing the access to credit.

Contemporary credit legislative measure for individuals take two broad forms: preventive measures and alleviative measures. Preventive measures relate to pre-contractual regulatory tools that enforce responsible market behaviours, as well as improve consumer decision-making (as discussed in Chapter 2, for example disclosure and information regulations, etcetera). The goal of the preventive measures is to curb market behaviours that lead consumers to borrow beyond their means.

On the other hand, alleviative measures are post-contractual regulatory tools which deal with consumers' debt problems once they have arisen. These relate to 'consumer bankruptcy' regulations that allow natural persons to get relief from their over-indebtedness. These entail a formal re-negotiation of the credit terms so that creditors are forced to compromise on repayment demands and the debtor is forced to pay to the extent possible so that a portion of the debt can be forgiveness. Such is the American novelty of the 'fresh start' that has

influenced consumer over-indebtedness regulatory interventions around the world in recent times.

Historically, the concept of ‘bankruptcy’ referred to a legal mechanism to be used for business failures only, with the notion that only firms would need or would be able to justify incurring debt (Tabb, 2005). Then the United States, and later England, expanded their conceptions of ‘bankruptcy’ to embrace debt relief for individual consumer debtors, and most of the OECD followed suit (Mann, 2002; Freyer, 2005; Tabb, 2005). Until recently, two primary paradigms for individuals’ insolvency existed: the American liberal paradigm which (until 2005) allowed consumers to discharge their debts quickly and easily, and the European welfare state paradigm which intended to promote equality by forcing consumers to ‘earn’ the fresh start through good behavior, making attempts to pay and generally acting in good faith (Tabb, 2005; Niemi-Kiesiläinen & Henrikson, 2005; Van Apeldoorn, 2008; Dickerson, 2008). In both case, the overriding aim being to enable the over-indebted to become productive members of the economy again. Because of wide-ranging public dissatisfaction on both fronts, the two approaches to consumer debt relief, originally so different, are now converging towards a balance between meaningful debtor protection and addressing creditors’ interests to the extent possible (Van Apeldoorn, 2008).

Consumer bankruptcy laws are still new to many countries. Where legislation did exist it often offered only a modest form of relief to debtors, giving greater emphasis to the satisfaction of creditors’ claims with stringent requirements and punitive implications for debtors (Tabb, 2005; Viimsalu, 2010). Political pressures to help those suffering with debts they are unable to pay have increased in many of these countries in recent years, with the recognition that unfortunate events (e.g., job losses, illnesses, family breakdowns) play a big part in the accumulation of those debts or the eventual inability to repay. This has resulted in recent reforms to move towards a more liberal debtor-friendly consumer bankruptcy system similar to the American system (Tabb, 2005; Niemi-Kiesiläinen & Henrikson, 2005; Van Apeldoorn, 2008; Viimsalu, 2010). The U.S. in 2005 also instituted reforms to its system which modified the fresh start concept and made it more restrictive by, inter alia, requiring

debtors to behave more responsibly; make bigger sacrifices towards repayment and proving that they genuinely deserve the discharge and, thus, ‘earn’ the right to the relief (Landry & Mardis, 2006; Dickerson, 2008). In doing so, the legislators attempted to strike a balance between rescuing some value for creditors and debtors’ right to debt relief. Such a balance introduces the idea of the compromise ‘earned fresh start’ (Dickerson, 2008; Van Apeldoorn, 2008).

In South Africa, the NCA introduced a legal mechanism to deal with debt problems of natural persons. (§s 85–87).¹¹² These entail a number of similar features with the contemporary consumer bankruptcy legislations in many of the financially developed markets, albeit with important differences.

In this chapter, the South African approach to consumer debt relief under the NCA is analysed with the aim of providing an understanding of why it is still not equal to the task of providing comprehensive relief for, and rehabilitation of, consumers. Precisely, the analysis contributes to the literature by showing that the debt relief and rehabilitation based on the principle of ‘satisfaction by the consumer of all responsible financial obligations’ (as provided for under the NCA) is futile and likely to cause more harm than good to debtors’ welfare. This is done against the background of recent developments in the ‘fresh start’ idea, with particular attention to the American, Japanese and European approaches to debt discharge. Given the increasing spread of consumer credit around the world, and the ensuing scale of delinquency as well as fragility of household incomes, finding new and universal denominators for dealing with debt-related problems has never been more important. Examining variations in national legislations to protect consumers helps to pinpoint South Africa’s place in relation to modernisation and rationalisation in the context of social and economic law reform at the global level. This analysis begins with the rationale for legal intervention to relieve consumer debt problems, followed by an overview of the legal approaches to consumer over-indebtedness in South Africa, Japan and the U.S and an

¹¹² Solutions to alleviate debt already incurred are also provided under the provisions of the *in duplum* rule (§ 103(5)), settlement of the credit agreement (§ 125), early payments (§ 126) and surrender of goods (§ 127), but these mainly aim to prevent creditor losses.

overview of the common characteristics of the European approach to the fresh start¹¹³. This is followed by the identification of both the common and divergent characteristics that exist in the South African and other systems. The chapter concludes with a discussion of the reasons why the South African approach is not equal to the task of providing meaningful relief and rehabilitation of consumers and, consequently, policy recommendations. Throughout this work, the terms insolvency and over-indebtedness are mutually interchangeable and refer to a situation in which debtors' indebtedness has reached a level where they cannot continue paying their debts as they fall due or appear to have no reasonable prospect of being able to pay the debts when they fall due, without causing undue strain on their personal or family welfare (Niemi-Kiesiläinen & Henrikson, 2005; Stamp, 2009; Viimsalu, 2010). This is essentially the same definition used by the South African NCA.

6.2 The rationale for consumer debt relief

Why would a 'market' economy bother itself with debt relief when there are safe-guards in place to prevent irresponsible credit practices (as well as other social safety-nets)? The rationale for implementing legal provisions to relieve consumers of problematic debts speaks to how and why people become over-indebted in the first place, and the consequences thereof (Apeldoorn, 2008). With regards to the 'how and why', empirical evidence suggests two distinctive factors: irresponsible market behaviours and unavoidable circumstances. With the former, governments institute regulations to curb as well as remove incentives for reckless lending and borrowing – it is then expected that lenders will behave responsibly and only lend to those who can afford repayments. As for the latter, it has been realised that such regulations are often not enough, because even where credit is used prudently or even where lenders only lend reasonable amounts and only to those with visible means to repay, some might still find themselves unable to continue satisfying their obligations. Due to increases in the cost of living, some people may get over-extended as they attempt to keep up. For others, household situational factors or changes thereof might dictate (e.g., Getter, 2003; Disney et al., 2008; Keese, 2009).

¹¹³ This does not suggest that there is a harmonisation in the substantive aspects of consumer debt relief in Europe.

Some consumers may have the power to control their consumption levels, they may even have accumulated some modest assets. They may, however, find themselves helpless if hit by unanticipated negative shocks like job loss, business failure, divorce, illness, or even an armed conflict (Getter, 2003; Dickerson, 2008; Draut & Silva, 2003). The situation may even get worse and the debt levels may escalate if they are forced to borrow more either to attempt to pay old debts or to bridge their daily consumption obligations – often from the dangerous unscrupulous underground lenders since they may no longer qualify for mainstream credit. For such reasons, it becomes imperative for the government to intervene and offer a helping hand through a legal mechanism that offers some form of relief to such unfortunate consumers as a social and moral obligation (Apeldoorn, 2008).

With regards to the consequences of over-indebtedness, the costs may be far-reaching, affecting the whole family, the lending industry and the state. Besides being a serious economic problem which erodes economic productivity of the people concerned as well as the financial wellbeing of their dependents, empirical studies have found that over-indebtedness can also lead to serious socio-psychological problems, often leading to abject living standards, exclusion from the social settings and escapism (Apeldoorn, 2008; Munster et al., 2009; Lupica, 2009; Rueger et al., 2011). If left to their own devices or at the mercy of lenders, such individuals may descend into lives of hopelessness with very little incentive to work more than is needed for survival and this may affect the economy as well (Steiger, 2006; Niemi-Kiesiläinen & Henrikson, 2005). On top of the financial losses incurred, a lender also loses a client because without a viable intervention, over-indebted debtors are not expected to participate in future borrowing.

Because of these outcomes, the necessity for a state's intervention becomes self-evident. Such intervention should entail a framework for relief and exit from the over-indebtedness which can be delivered by re-organising the unfortunate debtors' burdensome obligations – to the extent possible – and then discharging them of the rest (Tabb, 2005; Niemi-Kiesiläinen & Henrikson, 2005).

This is what modern states do if their consumers lose the capacity to repay their debts within a reasonable period of time and have no prospect of doing so without unduly burdening family lives. It is out of a realisation that over-indebtedness often results from situations beyond the consumers' control. In addition, reclaiming the financial health of over-indebted debtors is of benefit to lenders as well, since debtors will be expected to re-enter the market after rehabilitation. Here lies the need for the fresh start.

While situations differ from country to country, empirical studies have shown that many of the causes and consequences of over-indebtedness are common to most countries. It is for these reasons that the 'earned fresh start' doctrine has become the meeting point of contemporary consumer bankruptcy reforms. Empirical results in this dissertation and from other experiences suggest that shocks play a huge role in consumer over-indebtedness in South Africa. It may even be argued that shocks are more important in a context like South Africa than in the U.S. or Europe (where the fresh start is already established) due to the poverty situation here, as well as the high unemployment rates and lower levels of financial buffering. In addition, the pressures to spend upon a background of insufficient incomes, large dependencies and the ever rising cost of living is an important reality of households in South Africa. This creates desperation which exposes consumers to exploitation, often resulting in irrational borrowing activities and consequently a further deterioration of their financial positions.

Such scenarios are exactly what make debt relief and rehabilitation measures in the frame of the fresh start regulatory framework a greater necessity for South Africa. Of course, some may argue that South Africa is different (indeed all countries are) and that rehabilitation may not work in a context where shocks often have long-term effects. For example, in South Africa, some people take years to find another job after losing one compared with the U.S. or Germany where it could be a matter of weeks or months. The following scenario provides, in a nutshell, the justification for such measures in a context like South Africa. Consider, for example, a hypothetical debtor who is the sole bread-winner, who loses a job and spends more than a year unemployed, searching for another job. He (or she) is obviously unable to

continue paying his debts and his creditors start hounding him/her at every turn. The horrible debt collectors are forever stationed at his door yet he has no prospects of paying them in the foreseeable future. Consider that even if he were to sell everything his family has in order to settle some of the debts, he still cannot settle all debts and other creditors are demanding aggressively. Consider what will happen or what he might do if no helping hand is forthcoming. In the first instance, he probably resorts to informal moneylenders who charge very high interest rates. Unable to pay them, he and his family either end up with nothing, or he might even turn to crime or worse. It has even been argued that the inability of current legislation to intervene appropriately and rescue over-indebted workers when lenders' repayment demands exceed what they can genuinely satisfy might be responsible for some of the violent workers' strikes in recent times (James, 2013). Such scenarios underpins the necessity of pure 'fresh start' relief and rehabilitation tools while of course giving regard to the other social policy needs and local conditions.

6.3 The South African approach to debt relief

The South African National Credit Act 34 of 2005 (NCA) in its preamble states that one of its main objectives is to address the problem of over-indebtedness¹¹⁴ by providing for a harmonised system of debt restructuring, enforcement and judgment 'based on the principle of satisfaction by the consumer of all responsible financial obligations'.¹¹⁵ In essence, the Act provides a framework for relief from over-indebtedness that allows the consumer the opportunity to survive the immediate consequences of his or her over-indebtedness. While this is the central premise of contemporary legal relief measures, there are major inadequacies that might hamper this objective. The statement that the provision is based on the 'principle of satisfaction by the consumer of all responsible financial obligations' suggests immediately that the debt review is mainly concerned with recuperation of creditors' claims rather than

¹¹⁴ NCA, § 79 (1) defines an over-indebted consumer in these terms, namely that a 'consumer is over-indebted if the preponderance of available information at the time a determination is made indicates that the particular consumer is or will be unable to satisfy in a timely manner all the obligations under all the credit agreements to which the consumer is a party, having regard to that consumer's- (a) financial means, prospects and obligations; and (b) probable propensity to satisfy in a timely manner all the obligations under all the credit agreements to which the consumer is a party, as indicated by the consumer's history of debt repayment'.

¹¹⁵ NCA, § 3 (g) and (i).

relief for debtors. On the basis of consumer protection, this is problematic in the sense that given the conditions under which most people default on their obligations, it is possible that many debtors are left with no means to satisfy even the smallest insolvent claims and may not be able to get out of that adverse situation for a long time to come.

Chapter 4 Part D of the NCA tackles over-indebtedness in terms of a natural person (hereinafter ‘the debtor’ or ‘consumer’).¹¹⁶ This part introduced the provision of ‘debt review’ (NCA, § 86) which speaks to the alleviation of over-indebtedness and rehabilitation of over-indebted debtors. Under the debt review, a debtor who is over-burdened with debt may apply – in a prescribed manner and form – to a ‘debt counsellor’ to have him/her declared over-indebted (pursuant to section 79(1) of the Act),¹¹⁷ so that he/she may be relieved of his/her indebtedness. A debtor facing repayment problems may also be referred to the debt counsellor by the court, credit provider or the National Credit Regulator (NCR). There are essentially two separate proceedings with a common end: (1) debt review proceedings which are conducted by the debt counsellor and entail the evaluation of the case, (2) debt re-arrangement which is conducted by the court based on the debt counsellor’s recommendation.

According to Roestoff et al. (2009), the success of the Act's provisions in this regard depends to a great extent on the effectiveness of the debt counselling process and the debt counsellor. The Act defines a debt counsellor as a ‘neutral person who is registered in terms of section 44 of the Act for the purpose of offering a debt counselling service’¹¹⁸ subject to specific registration requirements set forth in sections 44 and 45¹¹⁹ of the Act. Debt counselling (as defined under the Act) essentially means assisting the over-indebted consumer through the process of debt review.

¹¹⁶ This part not does not apply to credit agreements or proposed credit agreements in terms of which the consumer is a juristic person (NCA § 6(a)).

¹¹⁷ NCA, § 86(1).

¹¹⁸ NCA Regulations, Regulation 1.

¹¹⁹ Read with NCA Regulations, Reg. 10: ‘The requirements include, inter alia, the provision that only natural persons may apply to be registered as Debt Counsellors; must adhere to certain minimum standards relating to education, experience and competence and must demonstrate an ability to manage their own finances’ (NCA Regulation 10(b)(aa)).

The roles of debt counsellors in the debt review processes are wide-ranging. They are tasked with explaining what the debt review entails, the debtor's rights and responsibilities during the process, analyse the debtor's situation and making recommendations to court on the matter. Upon application, the debt counsellor shall investigate the debtor's financial situation¹²⁰ in order to determine whether there are grounds to admit the case for relief.¹²¹ In terms of section 86 (7), at least one of the following three scenarios shall be expected from the debt counsellor's assessment of the consumer's indebtedness:

- (i) The consumer is not over-indebted, in which case the debt counsellor must reject the application in a manner and form as prescribed by NCA Regulation 25.¹²²
- (ii) The consumer is over-indebted, in which case the debt counsellor shall make a recommendation to the Magistrate's Court to re-arrange one or more of the debtor's obligations.¹²³ Also, under this scenario, the debt counsellor may recommend that the court declare one or more of the debts in question to be 'reckless',¹²⁴ – if they are found to be so – pursuant to the provisions of section 80 and 81 of the NCA.¹²⁵
- (iii) The consumer is not over-indebted, but is nevertheless experiencing, or likely to experience difficulty satisfying all his/her obligations in a timely manner. The debt counsellor may then recommend that the consumer and his/her respective credit providers voluntarily consider and agree on a plan of debt re-arrangement.¹²⁶ If the parties agree, the debt counsellor shall draft the agreement as a consent order in terms of section 138 of the Act and this will be binding as an order of the Tribunal or a Court.

¹²⁰Giving regard to, inter alia, the debtor's financial assets, prospects and liabilities pursuant to section 79 and regulation 24(7) (NCA regulation 24 (1) provides a list of information and documents required to file a petition in respect of a debtor who wishes to be declared over-indebted).

¹²¹Roestoff, Haupt, Coetzee, & Erasmus (2009) have suggested that the first task of the debt counsellor in the debt review process is to determine whether the consumer is indeed over-indebted, likely to become over-indebted, or not over-indebted at all.

¹²²NCA, §88(7)(a): The application may still be rejected even where the debt counsellor has concluded that a particular agreement was reckless at the time it was entered into.

¹²³ NCA, § 86(7)(C) (ii).

¹²⁴ Definition of 'reckless credit' see chapter 2 (subsection 2.5.4): i.e., credit agreements entered into without proper assessment of the applicant's creditworthiness by the credit provider or where the credit provider extends credit even when it is clear that the consumer could not afford or understand the terms of the credit (§. 80).

¹²⁵ NCA, § 86(7)(C)(i).

¹²⁶ NCA, § 86(7)(b).

If as a result of the evaluation, the debt counsellor rejects the application or the parties fail to consent to the debt counsellor's re-arrangement proposal, the consumer – with leave of the Magistrate's Court – may apply directly to Court,¹²⁷ in the prescribed manner and form, for an involuntary debt restructuring.¹²⁸

Roestoff et al. (2009) state that – based on section 129 of the NCA – there are no legal grounds to compel an over-indebted consumer to seek debt restructuring. Instead, a consumer may simply discontinue repayments and wait for a credit provider to enforce a credit agreement in respect of which he/she is in default, and then raise the issue of over-indebtedness in court. Under section 129, a creditor cannot commence legal actions against a defaulting debtor before drawing the debtor's attention to that fact in writing¹²⁹ and meeting the requirements set forth in section 130 including a referral to the debt counsellor.¹³⁰ The creditor shall also propose that the debtor refer the matter to an alternative dispute resolution agent, consumer court or ombudsman with jurisdiction.¹³¹ The aim of such a proposal should be to reach a resolution without the necessity of a potentially protracted litigation process. While the extent of compliance by the lender in this regard is unknown, anecdotal evidence suggests that many consumers only learn of the lenders' intentions to pursue repayment through court summonses. This means that lenders effectively bypass the requirements of sections 129 and 130 to pursue repayment.

¹²⁷For the definition of Court see Government Notice 288 of 2011, Government Gazette No.34281 (11 May 2011) 'court means Magistrates' Court established in terms of the Magistrates' Courts Act, 1944 (Act No. 32 of 1944), having jurisdiction over a consumer by virtue of such consumer's residence or place of business or the Debt Counselor carrying on business in the jurisdiction of such court irrespective of the monetary value of the credit agreements being considered by the court'.

¹²⁸NCA, § 86 (7)(b) & (c) and § 86(9).

¹²⁹NCA, § 129(1)(a).

¹³⁰NCA, § 130 (1): 'Subject to §§ (2), a credit provider may approach the court for an order to enforce a credit agreement only if, at that time, the consumer is in default and has been in default under that credit agreement for at least 20 business days and-

(a) at least 10 business days have elapsed since the credit provider delivered a notice to the consumer as contemplated in section 86(9), or section 129(1), as the case may be;

(b) in the case of a notice contemplated in section 129(1), the consumer has- (i) not responded to that notice; or (ii) responded to the notice by rejecting the credit provider's proposals; and (c) in the case of an installment agreement, secured loan, or lease, the consumer has not surrendered the relevant property to the credit provider as contemplated in section 127'.

¹³¹ Note that the South African legal system tries to provide for out-of-court settlements in all sorts of disputes,

A creditor who proceeds with legal actions against a defaulting debtor may still be encumbered by the provisions of the law. In terms of section 85, the court may still exercise its discretion to either refer the matter to a debt counsellor who will start over by evaluating the consumer's debt situation¹³² and then making a recommendation to court in terms of section 86(7) to declare the debtor over-indebted and henceforth take steps to relieve the debtor of the over-indebtedness.¹³³ In practice, this provision might prove to be redundant, as long as the creditor can still use alternative legal avenues.

A debt counselor who receives a petition for debt review shall notify all credit providers to whom the consumer is indebted and every registered credit bureau.¹³⁴ The law presumes that notifying these entities will prevent consumers from entering into further credit agreements while under the debt review process.¹³⁵ The debt counsellor shall have 30 business days from the date of the application for debt review to make a determination in terms of section 86(6) and another 30 business days to take action as contemplated in section 86(7)¹³⁶ failing which, the creditor may proceed to enforce the credit agreement in question.

The NCA does not prescribe any application procedure for debt re-arrangement while the exact procedure to be followed after application is not fully regulated in the Act or Regulations. The debt counsellor, therefore, is expected to use discretion to decide whether a consumer qualifies for debt re-arrangement or not while considering the entirety of the situation. Roestoff et al. (2009) note that in order to streamline the debt counselling procedure, major credit providers in consultation with debt counsellors and the NCR, agreed to certain guidelines which should be followed. One of these guidelines is that the debt counsellor should not make any recommendations to court before attempting a voluntary re-arrangement. In this case, the debt counsellor shall prepare and submit a debt restructuring proposal to the

¹³² NCA, § 85(a).

¹³³ Only a court can declare a consumer to be over-indebted. A debt counsellor's function in terms of section 86(6)(a) is merely to conduct a debt review in order to determine whether a consumer appears to be over-indebted or not, - based on available information.

¹³⁴ NCA Regulations, Reg 24(5).

¹³⁵ NCA, § 88(4).

¹³⁶ NCA Regulations, Reg 24(6). 130 Refer to Chapter 5, Part A or B and, or Chapter 6, Part A of the Act.

credit providers concerned. If the proposal is accepted by the credit providers, a consent order by the Magistrate's Court should be obtained.

Section 87 provides that upon receipt of the debt counsellor's referral, the Magistrate's Court must conduct a 'hearing' – based on its own discretion. Neither the NCA nor the Magistrates' Courts Act provide for a procedure in terms of which such a hearing should be conducted (ibid.: 276). Subsection 86(7)(c)(ii), simply states that, the Court – having regard to the debt counsellor's proposal and the consumer's financial means prospects and obligations – may re-arrange a consumer's obligations by, *(a)* extending the period of the agreement and reducing the amount of each payment due accordingly; *(b)* postponing during a specified period the dates on which payments are due under the agreement; *(c)* extending the period of the agreement and postponing during a specified period the dates on which payments are due under the agreement; or *(d)* recalculating the consumer's obligations because of contraventions in relation to unlawful credit practices.¹³⁷

The Act requires debtors and creditors to participate in good faith and to act responsibly during the review and in any negotiations designed to result in a debt re-arrangement and will comply with any 'reasonable' request by the debt counsellor for information necessary to evaluate the consumer's financial position.¹³⁸ In the case of a voluntary re-arrangement agreement, the debt counsellor cannot prescribe, but may propose the terms thereof. Neither the Tribunal nor Court can comment or interfere in the agreement.

The debt review process presents some important effects on the rights of the debtor and his/her creditors. Notably, the commencement of debt review proceedings will have the effect that any form of enforcement of the credit agreements in question (including any rights or security) will be stayed until the review or re-arrangement is terminated.¹³⁹ The debtor is also prohibited from entering into any further credit agreements other than consolidation agreements until the review or re-arrangement process is terminated or until the debtor fulfills

¹³⁷ Refer to Chapter 5, Part A or B and, or Chapter 6, Part A of the Act.

¹³⁸ NCA, § 86(5).

¹³⁹ NCA, § 88(3).

all the obligations as re-arranged.¹⁴⁰ A credit provider who enters into a credit agreement with a debtor whose debts are under review or re-arrangement (other than a consolidation agreement), risks being declared reckless with voidable implications for the agreements entered into.¹⁴¹

While the Act and regulations do not set out specific grounds for termination of the debt review (Van Heerden & Coetzee, 2011), the debtor or the debt counsellor may withdraw from the process at any time at least 60 business days after the commencement of the debt review. A credit provider may withdraw from the debt review process on grounds that the debt counsellor failed to arrive at an agreeable debt re-arrangement proposal within the mandatory 60 days. A debt counsellor may also withdraw from the debt review if the consumer is not acting in good faith or is not co-operating.

Termination of the debt review (due to non-compliance by debtor) has the consequence that the debtor will be dispossessed of his/her right to be afforded debt relief in terms of the Act and the creditor may proceed with legal actions to pursue the debtor for all payments due. Also, this fact will be recorded with the credit bureaux for a period of six months. However, the court hearing the case may on its own authority or upon petition by the debtor, order that the debt review resume on any conditions that the court considers to be just under the circumstances.

If the debtor satisfies all the obligations as re-arranged, the debt counsellor must issue a clearance certificate in a prescribed form.¹⁴² As a result, the credit bureaux and the National Credit Regulator must expunge from their records the fact that a particular consumer was subjected to debt re-arrangement and any information relating to the default that led to the debt review proceedings in question.¹⁴³

140 NCA, § 88(1): Section 88(2) provides that if a consumer fulfills obligations by way of a consolidation agreement he/she will still be barred from incurring more debt until he/she fulfills all of the obligations under the consolidation agreement, unless he/she again fulfills the obligations by way of a consolidation agreement.

141 NCA, § 83(2) & (3).

142 NCA, § 71 (read with Regulation 27).

143 NCA, § 71(5); read with NCA Regulation 17(1) as amended.

It appears that the consumer will only be relieved of the consequences of a debt review once he/she satisfies all the obligations under the re-arrangement order or agreement; or if his/her creditors decide to withdraw from the process. It should be noted that the NCA under section 86(7)(c)(ii) only permits the court to re-arrange the consumer's obligations and does not provide for a discharge. Only debts resulting from reckless credit agreements will be discharged completely, and even these may not be discharged unless the consumer is found to be over-indebted. Also, the contents of the repayment plan under the re-arrangement order are not regulated by the NCA or its regulations and the period of good conduct – being the period a consumer must stick to a prescribed or negotiated repayment plan – is not regulated under the Act.

The NCA is silent on the liquidation of the debtor's assets or treatment of security interests. Regulation is equally silent on how the over-indebted debtor would be required to pay the re-arranged obligations (using available assets or future employment income) – this is important because, while an insolvent debtor might find both available assets and future incomes feasible, quiet so often many will have one and not the other or none at all. As such, one might well ask what would be the case if no realisable assets or employment income is foreseeable. The proportion of the debtor's assets or income that must be devoted to payment of the re-arranged debts and the proportion that must be retained by the debtor for his/her family upkeep during the re-arrangement period are not regulated. Also, the regulation does not place restrictions on the number of times a debtor may apply for debt review or the type of debts that can be accommodated. Anyone can apply if he/she is unable to pay her/his debts as they fall due and if he/she is prepared to pay the prescribed debt counsellor's fees.

It seems, therefore, that the debt review process will attempt (albeit at relaxed terms) to satisfy the 'principle of satisfaction by the consumer of all responsible financial obligations' as long as it takes regardless of whether the consumer is able to or not: unless; of course, the lenders abandon the process. Given the wider discretion left to the court, however, perhaps some debtors might be lucky enough and get off lightly if the court is sympathetic to their situation, but this may leave the concerned lenders aggrieved and affect good faith, yet acting

in good faith is an important tool for the debt review procedure. It should also be noted that the Insolvency Act (24 of 1936), which dealt with both consumer and business insolvencies (before the NCA) is not superseded by the NCA. This means that a debtor can still seek relief under the insolvency law through sequestration by means of voluntary surrender as this offers some modest form of discharge, or the creditors might also consider an application for compulsory sequestration of the debtor's encumbered estate.

Notwithstanding the prescriptions presented above, this is what commonly happens in practice with regards to the debt review process (or debt counselling):

Debt counselling is simply a process where an over-indebted debtor applies to have his/her debts restructured, so that he/she is able to pay household expenses and still keep up with monthly debt repayment, but not a means to a financial fresh start. It usually involves reducing monthly payments and extending the period of payment.¹⁴⁴ A debtor applies to a debt counsellor who in turn notifies the creditors, meetings are arranged and repayment proposals are presented to creditors and if agreed to, the debt counsellor will collect a court order (consent order) from the clerk of the court and deliver it within five (5) working days to the affected consumer and each credit provider – not always the case, sometimes it takes weeks. As such all debt counselling applications will end in court. From then on, the debtor will commence repaying the re-structured obligations in a manner agreed to by the debt counsellor. Insolvent accounts for which legal action has been commenced before entering the process cannot be restructured, as such, creditors often take the opportunity to initiate legal action in time before a debtor applies for debt counselling. Creditors do not often agree to debtors' proposals and this necessitates an application to court to consider the debtors financial situation and then compel creditors to lower their demands.

During the repayment period, the debt counsellor will provide aftercare service and the debtor will pay a 5% monthly aftercare fee capped at R400. In addition, creditors cannot take any legal actions against the debtor and the debtor cannot take new debt. Because the law gives

¹⁴⁴“6 drawbacks of debt counselling. Available”: <http://www.women24.com/CareersAndMoney/Money/6-Drawbacks-of-Debt-counselling-20120606> [20 May 2014].

debt counsellors a lot of room to maneuver, many have designed their own processes and even neglected some regulations. The NCR notes that some consumers are often placed under debt review without their consent or even signing the mandatory form, some debt counsellors do not perform aftercare while others apply for, collect and deliver consent order arbitrarily.¹⁴⁵

6.4 The Japanese approach

Just like the South African NCA, the current Japanese regulatory regime for dealing with debt problems of natural persons was introduced as a response to long-standing deficiencies in existing laws, including the fact that the consumer insolvency law was a dislocated set of procedures developed according to historical circumstances (Steele, 2000). In addition, the pressure on legislators as a result of the financial crisis that preceded its introduction meant that the law reform process was a hasty affair, leaving gaps in the procedure which had to be revisited in the future (ibid.: 56). The legislation is set forth in two separate codes: the Bankruptcy Code (*Hasan-ho*) and the Civil Reconstruction Law (*Minjisaisei-ho*) (hereinafter collectively referred to as the “insolvency laws”) ¹⁴⁶ with the former largely intended to prepare the way for relief and rehabilitation (if necessary) and the latter for the actual rehabilitation.

Under the Japanese law an over-indebted consumer may choose to commence either liquidation or rehabilitation proceedings, while a creditor may petition or court may order that a debtor be subjected to one or the other. However, a liquidation procedure cannot precede a rehabilitation procedure.

6.4.1 Liquidation procedure

Liquidation procedures are provided for under the Bankruptcy Act (No. 75 of June 2, 2004 as amended by Act No.109 of December 15, 2006) which, according to its purpose, does not provide for rehabilitation of the debtor or the re-organisation of insolvent claims, but to

¹⁴⁵ NCR’s Circular NO.8 (September 2013) “The industry trends, practices and developments”. Available: [http://www.ncr.org.za/publications/circular_sep/Circular%20\(No.08ofSep-2013\).pdf](http://www.ncr.org.za/publications/circular_sep/Circular%20(No.08ofSep-2013).pdf) [20 May 2014].

¹⁴⁶ While these procedures are available to both natural and legal persons, there is a reorganization process provided for under the Commercial Code (*Kaisha Seiri*) which only applies to business corporations.

realise the debtor's assets in order to secure the opportunity for rehabilitation.¹⁴⁷ An application to commence liquidation proceedings can be made if the debtor is 'unable to pay' his/her debts as they fall due¹⁴⁸ or when he/she suspends debt repayment.¹⁴⁹ The order to commence proceedings may be denied on two grounds: if the expenses for the proceedings have not been prepaid, and where the petition is not filed in good faith.¹⁵⁰

Upon filing, the court shall institute measures to protect and preserve the property of the debtor, *inter alia*, by appointing a bankruptcy administrator to take immediate possession of the debtor's assets until the final court decision on the matter, as well as staying any creditors' action against the debtor – subject to an appeal by an interested party.¹⁵¹ The court may also appoint a bankruptcy trustee vested with the right to administer and dispose of the bankruptcy estate subject to the court's supervision.¹⁵² All assets of the debtor at the commencement of proceedings shall constitute the bankruptcy estate,¹⁵³ except those necessary to afford the debtor a decent family existence as contemplated in article 131 of the Civil Execution Act.¹⁵⁴ The Bankruptcy Act vests preferential security rights in holders of a special lien, right of pledge, mortgage or commercial lien. Such creditors may be allowed to exercise their security rights outside of the liquidation procedure.¹⁵⁵

Once all of the bankruptcy estate has been realised, and all the proceeds have been distributed to the creditors,¹⁵⁶ the court shall order the conclusion of the bankruptcy proceedings and give public notice to that effect,¹⁵⁷ while the debtor will be discharged from the remaining

¹⁴⁷ Article 1 of the Bankruptcy Act states the purpose of the law as to specify the 'proceedings for liquidation of property held by debtors who are unable to pay debts or insolvent, etc., to appropriately coordinate the interests of creditors and other interested persons ... with the aim of ensuring proper and fair liquidation of debtors' property, etc. and securing the opportunity for rehabilitation of their economic life'.

¹⁴⁸ The Bankruptcy Act, Art. 15(1), § 1: The application for admission to proceedings can be made not only by the debtor but also by creditors against the debtor.

¹⁴⁹ The Bankruptcy Act, Art. 15(2), § 1.

¹⁵⁰ The Bankruptcy Act, Art. 30(1).

¹⁵¹ The Bankruptcy Act, Art. 24, § 1.

¹⁵² The Bankruptcy Act, Arts 74 – 78, §1.

¹⁵³ The Bankruptcy Act, Art. 34 (1), §3: §§1.

¹⁵⁴ The Bankruptcy Act, Art. 34 (3), §3: §§1.

¹⁵⁵ The Bankruptcy Act, Art. 65, §3: §§4.

¹⁵⁶ Pursuant to the provisions of articles 194 to 200 of the Act.

¹⁵⁷ The Bankruptcy Act, Art. 220.

debts. According to the bankruptcy law, a debtor is deemed to have applied for discharge¹⁵⁸ by virtue of filing a proper petition for the commencement of liquidation proceedings. Non-dischargeable claims include claims for taxes, damages for torts, spousal support obligations, fines and similar obligations as well as claims known to the bankrupt but not recorded in the list of liabilities.¹⁵⁹

Discharge may be denied if the court finds evidence that the debtor acted in bad faith generally, with intent to disadvantage one or more of his/her creditors. Such cases may include concealment of property; giving special treatment to some creditors at the expense of others; or general breaches of duties.¹⁶⁰ However, even where the bankrupt falls under any of the listed non-dischargeable cases, the court may still grant a discharge if it finds it appropriate while taking into consideration the entirety of the circumstances particular to the case.¹⁶¹

Because the liquidation procedure places greater constraints on the debtor's freedoms with regard to property, including the fact that all non-exempt assets in the debtor's estate at the time of the bankruptcy adjudication become the property of the bankruptcy estate, the Japanese system treats the rehabilitation procedure more favourably. Thus, when a petition is filed to commence rehabilitation proceedings, a court may – if it thinks it necessary – order the suspension of existing liquidation proceedings (if any) until such a time when it rules on the petition for commencement of the rehabilitation proceeding.¹⁶² Also, liquidation proceedings cannot be brought against the debtor who is already under the rehabilitation process.¹⁶³

6.4.2 Rehabilitation procedure

Consumer rehabilitation procedures are provided for under the Civil Rehabilitation Act (No. 225 of December, 1999 as amended by Act No. 87 of 2005). Under this Act a petition for

¹⁵⁸ The Bankruptcy Act, Art. 248(4) §1.

¹⁵⁹ The Bankruptcy Act, Art.253.

¹⁶⁰ The duties of the debtor in bankruptcy are set out in articles 40(1)(i), article 41 or article 250(2) of the Act.

¹⁶¹ The Bankruptcy Act, Art 252(2).

¹⁶² Civil Rehabilitation Act, Art .26(1)(i).

¹⁶³ Civil Rehabilitation Act, Art. 39(1).

commencement of rehabilitation proceedings can be made if there is a risk that the debtor will become 'bankrupt' (which is defined to mean being subjected to liquidation) or the inability to repay debts as they fall due without causing substantial damage to the family's welfare.¹⁶⁴ Civil rehabilitation procedures are 'debtor-in-possession' type of procedures which means that a debtor who is the subject of rehabilitation proceedings will retain the right to manage and dispose of his estate¹⁶⁵ (if necessary) in good faith subject to supervision.

The procedure is commenced by filing a request at court. Upon filing, the court may – on a petition of an interested person or on its own authority – make a disposition to appoint a supervisor and designate acts that the rehabilitation debtor cannot conduct without the authority of the supervisor.¹⁶⁶ Access to this procedure is also heavily linked to the debtor acting in good faith and therefore, the court should dismiss with prejudice a petition for commencement of rehabilitation proceedings if it is reliably proven that the petition was filed in bad faith.¹⁶⁷ Also, the court shall not order the commencement of rehabilitation proceedings where the expenses of the proceedings have not been prepaid and where a proposed rehabilitation plan is unlikely to be approved by creditors.

The commencement of the rehabilitation proceedings has the effect that it precludes creditors from taking legal actions against the debtor in question including compulsory execution against the debtor's assets, bankruptcy or special liquidation petitions whilst any such proceedings already commenced will be stayed,¹⁶⁸ except in the case of secured creditors. Any court action pending against the 'rehabilitation' debtor's property as well as any pending rehabilitation claim shall be discontinued once rehabilitation proceedings begin.¹⁶⁹ Because the debtor retains possession of the property, the court shall retain the right to reverse any transactions or acts (in respect of the property) deemed abusive or dishonest with a potential

¹⁶⁴ Civil Rehabilitation Act, Art. 21(1) §1: 'When there is the risk that a fact constituting the grounds for commencement of bankruptcy proceedings would occur to a debtor, the debtor may file a petition for commencement of rehabilitation proceedings to the court...'.
¹⁶⁵ Civil Rehabilitation Act, Art. 38(1).
¹⁶⁶ Civil Rehabilitation Act, Art. 54(1 & 2) §1.
¹⁶⁷ Civil Rehabilitation Act, Art. 25.
¹⁶⁸ Civil Rehabilitation Act, Art. 39(1).
¹⁶⁹ Civil Rehabilitation Act, Art. 40(1).

to disadvantage creditors ('right of avoidance').¹⁷⁰ Actions such as gratuitously disposing of assets; concealment of assets or making selective irregular payments in a manner prejudicial to some or all of the 'rehabilitation' creditors may be subject to close scrutiny with voidable implications.¹⁷¹

Under the law, general unsecured creditors' claims which have arisen against the debtor prior to the commencement of the rehabilitation proceedings are considered insolvent claims (rehabilitation claims)¹⁷² and will be given equal treatment. The debtor and his/her creditors will have to agree on a repayment proposal (rehabilitation plan), under which, if a debt is to be assumed or the term for a debt is to be extended based on the plan, the term for such debt shall not exceed ten years¹⁷³ – barring special circumstances.

When a court's ruling to approve the rehabilitation plan becomes final and binding, all the reported rehabilitation claims admitted by the debtor and those not formally reported (but acknowledged) will be modified in accordance with the rehabilitation plan.¹⁷⁴ The rehabilitation plan in principle will run for a duration of three years, and can be extended to up to five years under special circumstances. The debtor will then be discharged from all other claims including those that were not acknowledged in the rehabilitation plan¹⁷⁵ excluding fines and penalties incurred prior to commencement of the rehabilitation proceeding.¹⁷⁶ The modification of rights under the rehabilitation plan will not affect creditors with security interests as these will retain the right to enforce their security interests ('right of separate satisfaction').¹⁷⁷ Also, the rights or claims of those who are liable jointly

¹⁷⁰ Civil Rehabilitation Act, Art. 127(1) §2.

¹⁷¹ Civil Rehabilitation Act, Art. 136 (1).

¹⁷² As in the bankruptcy proceedings, holders of special lien, right of pledge, mortgage or commercial lien will be vested with a preferential security rights and are allowed to exercise their security rights outside of the civil rehabilitation procedure subject to the court's foresight.

¹⁷³ Civil Rehabilitation Act, Art. 155 (3) §1.

¹⁷⁴ Civil Rehabilitation Act, Art. 179(1).

¹⁷⁵ Civil Rehabilitation Act, Art. 178.

¹⁷⁶ Civil Rehabilitation Act, Art. 155(4). Other non-dischargeable claims are listed in Article 181(1) and these include claims that could not be declared within the stipulated period for declaration of claims; claims that arise after the court ruling to vote on the draft rehabilitation plan; and claims known to the rehabilitation debtor but not formally acknowledged.

¹⁷⁷ Civil Rehabilitation Act, Art. 53: this means that secured creditors will not be affected by the commencement of rehabilitation proceedings and holders of security interests can go ahead and foreclose on their debtors without being affected by the civil rehabilitation process.

with the debtor (such as guarantors) or security provided by persons other than the rehabilitation debtor will not be affected by the plan modification.¹⁷⁸

In summation, because the central objective is to provide an over-indebted debtor with a quick exit from debt distress, in practice, the Japanese system offers over-indebted consumers two conduits to the fresh start either through ‘sell-out’ proceedings or ‘pay-out’ proceedings (Matsushita, 2006). The debtor can be admitted to a bankruptcy proceeding if he/she has some non-exempt assets and is willing to give them up (for the benefit of his/her creditors) in order to be free of over-indebtedness immediately. Or the debtor can agree to a rehabilitation procedure in which he/she keeps all assets in exchange for promising to pay off debts from future income over a period of time according to the rehabilitation plan. Which of these options suits the creditor better depends on the situation. Under the liquidation procedure, the debtor gives up his possessions, gets a discharge and gets on with his life. As an alternative, it had been proposed that as long as a debtor chooses a rehabilitation proceeding, creditors would be able to receive an amount no less than what they would receive under liquidation. The argument is that, the interests of creditors might be damaged, in the sense that they lose the opportunity to recuperate a bigger share of their claims from the debtor’s future income. The counter-argument was that when debtors choose liquidation, sifting through all debtors’ disposable incomes to ascertain their abilities to pay would be very time-consuming and not cost-effective. It was thus decided that over-indebted debtors can simply choose between either bankruptcy proceedings or rehabilitation proceedings, regardless of the amount of expected disposable income (ibid.: 270). This innovation made the Japanese system essentially more debtor-friendly with better prospects for rehabilitation.

6.5 The American approach

Making it harder for over-indebted consumers to avoid repaying their debts is easily justifiable if purchases of iPods, plasma TVs, Hummers, or sable fur coats cause most consumer over-indebtedness. But empirical data collected by prominent U.S. academics show this is not the case; medical debts, a divorce, or

¹⁷⁸ Civil Rehabilitation Act, Art. 177(2).

a job interruption cause most consumer bankruptcies in the United States (Dickerson, 2008:146).

The above statement gives the American system its justification in brief. Historically, the U.S. system has given over-indebted consumers a fresh start that allowed them to discharge their debts and become productive members of the economy again (Tabb, 1999). The social, moral and practical reasoning, according to Apeldoorn (2008), was that over-indebtedness is a social problem that can be caused by misfortunes over which people have no control and, as such, state intervention is required to prevent an overall deterioration of their economic situations.

The U.S. Bankruptcy Act (the U.S. Bankruptcy Code)¹⁷⁹ enables over-indebted consumers to seek formal financial relief by obtaining a discharge from some or all of their existing debts. The Act was amended on April 20, 2005 by the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA).¹⁸⁰ Until then, relief from over-indebtedness was open to everybody and debtors had the right to decide whether they wanted to attempt to pay some of their debts over a three-to-five-year period in what is called a “Chapter 13” repayment plan or seek a quick discharge in a “Chapter 7” proceeding without even attempting to repay those debts (Van Apeldoorn, 2008; Dickerson, 2008). Chapter 7 only required debtors to turn over the non-exempt part of their wealth for liquidation, but upon filing for bankruptcy all their future income was completely exempt. Under Chapter 13, debtors were obliged to repay only from non-exempt earnings. Under both procedures most unsecured debt was dischargeable (White, 2007).

Currently (under the BAPCPA), however, a debtor who files in good faith and makes an attempt to pay some of his debts to the extent that he/she has some resources to do so will get relief from the debts he/she cannot pay (Livshits et al., 2007; Dickerson, 2008). The main impetus for the introduction of the BAPCPA was the complaint that too many consumers who could afford to repay their debts were walking away from these debts so easily

¹⁷⁹ The US Code, Title 11- Bankruptcy of 1978, Pub. L. 95-598, Title I, § 101, 92 Stat. 2549 [hereafter 11 U.S.C.].

¹⁸⁰ Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (codified as amended in scattered sections of 11 U.S.C.) [Hereinafter BAPCPA].

(Dickerson, 2006). Thus the law intended to limit the ability to access a quick discharge (offered under Chapter 7) by forcing more consumers into Chapter 13 debt repayment plans instead. This entailed the introduction of a ‘means-test’ which requires consumers to pass an elaborate quantitative test¹⁸¹ in order to ‘earn’ the right to a fast track to discharge under Chapter 7 where a fraction of their debts can be paid off using available resources (if any), while keeping all their future incomes. Debtors who fail the means-test may file a Chapter 13 case under which they get to keep a greater share of their properties but pay a bigger fraction of the debt using future incomes over a period of 3-5 years after which, they can be discharged from their remaining debts.

Under the BAPCPA, a debtor shall be forced into Chapter 13 instead of Chapter 7 (or dismissed altogether) if it is established that the petition was filed in ‘bad faith’ or where the totality of the circumstances surrounding the debtor’s financial situation demonstrates bad faith.¹⁸² In addition, extra financial costs and administrative burdens were introduced under the law. These relate to the extra filing requirements and fees, restrictions on repeat filing¹⁸³ and administrative hurdles related to credit counselling and attorney certifications.¹⁸⁴

In summation, the recent reforms to the American system put greater restrictions on access, discharge, and the period of good conduct (Apeldoorn, 2008). The concept of ‘good faith’ became central to the process in a sense that the fresh start is reserved for consumers who, understand that they have a moral duty to make responsible spending decisions and make efforts to repay their debts where possible (Dickerson, 2008). Hence, discharge became more of a favour than a right.

¹⁸¹ 11 U.S.C. § 707 (b) (2) (A): Such a test would take into account a consumer’s income (adjusted for family size), monthly expenses and monthly expenditure on secured debt repayment.

¹⁸² 11 U.S.C. § 707(b)(3).

¹⁸³ 11 U.S.C. § 727(a)(8) and §362(c)(3).

¹⁸⁴ 11 U.S.C. § 109(h). In fact, section 109(h) is adamant that individuals are ineligible for relief under any chapter of the Code unless these counselling and financial management standards are adhered to Chapter 13 debtors are required to receive financial management training from an accredited educational provider with a few exceptions (§ 109 (h) 2 & 3).

6.6 The European approach

The European approach which requires the over-indebted debtor to make more sacrifices if they are to ‘earn’ a fresh start, has been seen as stricter and more conservative than the American approach. Observers, however, argue that the two systems are fast converging (White, 2007; Dickerson, 2008; Apeldoorn, 2008; Gerhardt, 2009; Viimsalu, 2010). The most notable move towards this convergence has been the decrease in the period of good conduct in most European systems and attempts to reduce other constraints to access to proceedings and discharge.

According to the European approach, which has for long been seen as a ‘welfare state’ approach, the consumer has a duty to behave responsibly and make considerable effort, usually in the form of a demanding repayment plan, and discharge is conditional upon fulfilment of the plan – but such discharge usually involves as many types of debts as possible (Niemi-Kiesiläinen & Henrikson, 2005; Van Apeldoorn, 2008; Viimsalu, 2010). The duration of the plan varies from 12 months (the U.K.) to three years (the Netherlands) to five years (Belgium, Denmark, Finland and Sweden), to six or seven years (France, Austria and Germany). The longest is for Ireland (twelve years under certain circumstances – with a minimum of five years) (Gerhardt, 2009). All plans usually contain some form of payment, but the requirements vary greatly. Under the European system good payment morals are more important than the interests of creditors, and some states (e.g., France and the Netherlands) are able to grant discharge without any payment at all – citing hardship cases, for example where there is a reason to conclude that the debtor is permanently incapable of payment and where debtors face longer periods of unemployment. In Austria, on the other hand, there is a requirement of a minimum payment of 10 per cent, which excludes the really poor debtors from the process (Apeldoorn, 2008).

In some countries attempts at initial out-of-court settlement are regulated. The debtor is required to make an attempt to reach a settlement with his creditors before going to court (Germany, the Netherlands, Finland, Austria, France and Luxembourg), and in some countries such an attempt is a prerequisite for the opening of consumer insolvency

proceedings in court. However, the requirements vary between jurisdictions. A demonstration of good faith is also an important aspect of the European approach. While, the material aspects of laws differ, the European approach contemplates a rehabilitation of the debtor's financial health which should be achieved through partial payment of the debts, appropriate counseling, and enforcement of behavior and consequently, discharge.

6.7 Common characteristics

Although the material aspects of the contemporary consumer bankruptcy laws in South Africa are considerably different to what is offered in Japan, the U.S. and Europe, a few common characteristics can be identified, especially in regard to the welfare and moral issues that justify consumer protection. During the consideration of the current regulatory regimes in South Africa, Japan, the U.S. and, indeed, in most of Europe, legislators and commentators alike made the case for the necessity of well-regulated measures using the three common arguments: the need to protect consumers who suffer misfortunes; the dangers of staying in debt distress for an extended period of time; and the necessity of eliminating abuse and opportunism by consumers. As a result, a number of aspects in all these regulatory regimes are tied in with the two main ideals that typify the contemporary fresh start, namely, 'the consumer's right to a relief' and 'the consumer's duty to behave responsibly' (Dickerson, 2008). The substantive requirements vary greatly.

With regards to the principle of the consumer's right to relief and rehabilitation, all the three systems and, indeed, many others (e.g., most of Europe, Canada, and Australia) recognise the fact the consumers who find themselves in need of this legal intervention are often in a precarious state. The impediments to entry are in most cases very low as long as the consumer is in financial distress and 'is' or 'will be' unable to satisfy present and, or future financial obligations as they fall due (i.e., over-indebted). Both in South Africa and Japan general cessation of payment by the consumer can be enough to infer over-indebtedness and eligibility for protection¹⁸⁵ while in the United States, even those who fail the means test can

¹⁸⁵Japan (Bankruptcy Act, Art. 15 § 2, Civil Rehabilitation Act, Art. 21(2); South Africa (NCA, § 130, read with §129 & §85).

still get relief under Chapter 13. In all these jurisdictions it seems very unlikely that a distressed debtor will be turned away from proceedings, even though the grounds for this are clearly spelt out.

Another important reflection of the idea of the debtor's right to relief and common to all these jurisdictions is the moratorium. This is a temporary court order that suspends creditors' actions and right to receive payment upon commencement of proceedings. In addition, in Japan any other legal or administrative proceedings in respect of the debtor will be temporarily stayed. While the moratorium helps to prevent the dissipation of the debtor's assets before a solution is reached, it creates a regulated environment for the debtor to get momentary relief from financial distress which, in turn, gives the debtor a better chance of recovery (Feibelman, 2009; McBryde, Flessner & Kortmann, 2003). In other jurisdictions like France, the moratorium may last for up to 2 years.

Contemporary consumer debt relief processes in all these systems also require over-indebted debtors to behave responsibly by not electing to disadvantage their creditors and not aggravating their situations by consuming more debt while under the debt relief procedures (i.e., act in good faith). This principle also contemplates that the consumer will make an effort to pay at least some – if not all – of his/her debts if he/she is to benefit from the legal protection available to him/her. Again, the substantive requirements of these issues differ greatly.

The South African legislation provides for a negotiated 're-arrangement plan' similar to the American chapter 13 repayment plan and the Japanese rehabilitation plan. The repayment plan is the staple of the European system as it is closely regulated to give the debtor time to adjust his/her consumption behaviours, and the creditors an opportunity to recuperate some payments. While the level of regulation on this aspect and the outcomes differ, the repayment plans largely entail, inter alia, setting aside a portion of the debtor's assets for his/her creditors' benefit; re-structuring of payments; and modification of creditors' and debtors' rights under the agreements in question. There is a particular importance attached to the length of time a debtor must remain under the constraints of the repayment plan or period of good conduct

(as it is commonly known in Europe and the U.S.). This period and the corresponding repayment plan are not only intended to recoup some value for creditors, but also – equally important – to give consumers an incentive to stay away from borrowing for a while and possibly learn wiser spending choices. While the length is not regulated under the NCA, certain conducts are prescribed including not accessing any further credit and a demonstration of effort. In the U.S. where the law was considered too lax, this period has effectively been increased (under Chapter 13) while in Europe where the laws was considered to be relative harsher to consumers, the period of good conduct was considerably reduced in order to achieve stronger consumer protection (Gerhardt, 2009). The most radical change has been in the U.K. where the period was reduced from 3 years to 12 months.

In South Africa, one of the main objectives of the debt counselling process is to restore the debtor-creditor relationship after the occurrence of over-indebtedness and if the process can get debtors and their respective creditors to agree on the rearrangement plan without the need for the court process, then the debt counselling process is considered a success. While it is welcomed (but not emphasised) in both the U.S. and Japan, the initial attempt at out-of-court agreement between the debtor and his/her creditor is a very important aspect of debt relief in most of Europe. In some countries, like France and Germany, initial out-of-court negotiations are regulated under the law and obligatory.

In most contemporary systems there are financial costs (although relatively small in all contexts) and administrative hurdles that have to be faced by debtors seeking relief. This is an important feature of the current U.S. system under the BAPCPA for reducing incentives to abuse the consumer bankruptcy process (Dickerson, 2008; Gerhardt, 2009), while both the South African and Japanese systems provide for admission fees and expenses for third parties such as attorneys and/or mediators. They also have in place, elaborate administrative procedures requiring a multitude of documents and spanning several months and/or meetings. Such expenses and administrative burdens should help reduce the incentive for opportunistic filing or using consumer bankruptcy as a solution of first resort. The fees and stringent requirement may also have a downside, given that many debtors who seek legal relief from

over-indebtedness are usually in such a poor financial shape that they may not be in a position to afford such fees and therefore may find themselves excluded from the legal protection that they so deserve.

In encouraging responsible consumer behaviors the three jurisdictions also widen the scope of the personal insolvency law to include prevention of over-indebtedness. Both the South African and Japanese law provide for sanctions for antecedent transactions based on dishonest and reckless behaviors. Huge differences exist with regards to the type of actions targeted, and the sanctions thereof. In the Japanese system, the financial dealings of the debtor prior to the commencement of the proceedings including transfer of assets and payments are scrutinised and are reversible by the court upon petition of an interested party. The South Africa legislation scrutinises the legality of the credit agreements in question under its reckless credit provisions. In case of the U.S. law, the reforms under the BAPCPA placed restrictions on repeat-filings - being the number of times a debtor can be admitted to bankruptcy or the time period between discharges.¹⁸⁶ All these requirements and restrictions mean that if the debtor is to benefit from the relief and protection of the state, he/she has the duty to behave responsibly, modify his/her future spending habits and avoid being caught up in the same situation.

The aspects outlined above show that the current South African consumer debt relief regulatory regime certainly has similarities with those in the financially developed world, – at least in principle – but it is also important to stress that, considering the great differences in contexts, notably with regards to the general regulatory patterns, level of economic growth as well as the social and economic policy priorities, some differences in approach are to be expected.

¹⁸⁶ In Chapter 7 a debtor shall not receive a discharge unless six to eight years have passed since the last discharge depending on circumstances set out in section 727(a) (8) and a Chapter 13 shall not receive a discharge unless two to four years have passed since the last discharge pursuant to the provisions of section 1328(f).

6.8 Divergent approaches

While the South African approach incorporates many similar aspects (especially with regards to the procedural insolvency law and the general purpose of the law) to those in Japan, the U.S. and Europe, significant differences still persist between the South African system and these systems, especially in relation to the fresh start idea. The important differences are evident with regards to such aspects as the types of proceedings commenced, the level of creditor participation in proceedings and number of insolvency institutions involved in the process. Other differences relate to the treatment of secured creditors and treatment of fraudulent actions. Important differences are also evident in regulations regarding the parameters for defining insolvency claim and exit from the process.

6.8.1 Types of proceedings commenced

In South Africa, consumers (referring to natural persons) who find themselves over-indebted and unable to continue with their debt repayments may apply (or be referred by court or creditors) for debt review under the NCA and to be declared over-indebted so that they may get relief from their over-indebtedness, which is essentially provided by way of restructuring obligations. The debt relief process entails two intertwined stages: debt review and debt restructuring (Van Heerden & Borraine, 2009). The debt review is the initial stage, which occurs before the debt counsellor and involves fact-finding and attempts at amicable solutions (i.e., debt counselling). The second stage comprises an actual declaration of over-indebtedness and the subsequent restructuring of debt which is done by the court.

The Japanese consumer insolvency regime comprises two different sets of procedures set forth in two separate codes: liquidation-type procedure and the rehabilitation-type procedure. Under this regime, an over-indebted consumer is free to commence either a liquidation procedure (to have his/her assets realised and the proceeds distributed between creditors) or a rehabilitation procedure (where the debtor keeps the assets but pays from future incomes). However, the rehabilitation procedures are explicitly favoured by the credit policy because debtors are able to keep their property and pay from future income. A choice may also be made based on the individual debtor's economic situation at the time of filing. The American

system under the BAPCPA – like the Japanese system – provides for two procedures (but under the same code). Debtors who are unable to continue satisfying their debt obligations can apply to be relieved under Chapter 7 proceeding (use available resources to pay a portion of the debt to the extent possible) subject to a ‘means test’. They may also seek relief under Chapter 13 proceedings and attempt to repay some of the debts using future incomes.

The major difference between these two systems and the South African approach is that debtors have at least two alternatives to get relief and that debtors are treated differently depending on their financial situations. Further, since both alternatives are governed by the same legislation, there is no regulatory overlap. However, while the South African NCA provides for the debt review, creditors can still successfully use other, more creditor-friendly, measures under different legislations, such as the Insolvency Act (which governs procedures for insolvent companies, consumers, and other juristic entities), or the Magistrates’ Court Act 32 of 1944, which governs procedures for administration orders. This is still possible because the NCA states in section 2(7) that, except as specifically set out in the Act, its provisions are not to be construed as limiting, amending, repealing or otherwise altering any provision of any other Act.¹⁸⁷

6.8.2 Creditors’ participation in proceedings

Greater creditor participation is an important aspect of the debt relief procedure as it encourages good faith from the creditors and motivates them to compromise on repayment demands during negotiations for a repayment plan. Compared with South Africa, the Japanese and most European insolvency regimes provide greater legal means for creditors to participate in insolvency proceedings to which they are party. The Japanese system provides for creditors’ committees which represent the interests of all insolvency creditors and present opinions on the proceedings. In other cases, creditors may choose third-party representatives

¹⁸⁷Section 2(7) of the NCA states that the provisions of the Act are not to be construed as ‘(a) limiting, amending, repealing or otherwise altering any provision of any other Act; (b) exempting any person from any duty or obligation imposed by any other Act; or (c) prohibiting any person from complying with any provision of another Act’; except in the case of (a) The Usury Act, 1968 (Act No. 73 of 1968); (b) the Credit Agreements Act, 1980 (Act No. 75 of 1980); and (c) the Integration of Usury Laws Act, 1996 (Act No. 57 of 1996) (§ 172(4)).

(usually lawyers) to manage their affairs.¹⁸⁸ Also, insolvency plans have to be approved either by the majority of creditors or a proportion of those with voting rights unless special circumstances dictate.¹⁸⁹ Creditors under the Japanese insolvency regime have the legal right to appeal against any decision of court or proposal of the debtor they consider disadvantageous to their cause.

Under the South African system, creditors make very little input in the debt review process. Creditors' participation in the proceedings is limited to providing the necessary information to the authorities during the evaluation of the case. Creditors may refer debtors – in writing – to debt counsellors or the court, but will have no say in the restructuring plan and cannot appeal against the restructuring order or take further legal action. The danger there is that creditors will lack the motivation to use the process and this may impact on their willingness to provide information in a timely manner if required to do so, especially in the case of smaller claims. This could even be one reason why creditors bypass the debt review process and elect to seek payment through other means.

6.8.3 Insolvency institutions

Under the South African law, only two institutions (debt counsellor and magistrates court) are involved in the insolvency procedure. A petition to commence proceedings is lodged with the debt counsellor who investigates the merits of the case and makes a recommendation to the Court for appropriate action.¹⁹⁰ Where parties can agree to a voluntary re-arrangement, the debt counselor may finalise proceedings but will still need the court for the consent order. The role of the court is, in many cases, limited to ratifying the suggestions of the debt counsellor and hearing of incidental matters that may arise. In most of Europe the court is the only responsible institution in the debt relief process except in countries where initial out-of-court negotiations are regulated (Germany, Netherlands, Austria and France) that a state-approved third party may be required.

¹⁸⁸ Civil Rehabilitation Act, Art. 90; Bankruptcy Act, Art. 144.

¹⁸⁹ Civil Rehabilitation Act, Art. 171-4; Bankruptcy Act, Art. 138-139.

¹⁹⁰ Even in cases where the petition was lodged directly with the Magistrate's Court, it may be referred back to the debt counsellor for evaluation and recommendation.

The Japanese insolvency law provides for the judicial appointment of several discretionary authorities to coordinate the insolvency process. The court receives and hears the petition, appoints relevant institutions either on its own motion or on the petition of an interested party. Such institutions may include (although not always) the trustee in liquidations; supervisors; investigators and the creditors' committee. Under the U.S. system, when a petition is filed, the U.S. trustee (or the bankruptcy court) appoints an impartial case trustee to administer the case and liquidate the debtor's non-exempt assets and, if all the debtor's assets are exempt (as in most Chapter 7 cases), the administrator will not be appointed.

The reasoning behind having a limited number of authorities is based on the need to have an expedited process with limited costs (both material and otherwise) to the debtor. This may, however, also present capacity problems along the way, and in the case of South Africa, capacity problems have already emerged with many reports of a backlog of cases in court. The task team chosen by the NCR in 2009 to look into the debt counseling process reported a lack of capacity and delays in the Magistrates' Courts as the main problem affecting the process.¹⁹¹

Having several authorities may also present its own unintended problems. Steele (2000) argues – in reference to the Japanese system – that while the appointment of several institutions may make the process more flexible and good for supervision of debtors' post-filing actions, it may also become an obstacle to speedy rehabilitation.

6.8.4 Treatment of secured creditors

Secured creditors are not accorded special treatment under South African law. The NCA limits the ability of any creditor to proceed with litigation to enforce security rights under a credit agreement against a consumer who is under debt review or who is subject to a debt restructuring order or agreement.¹⁹² Although provisions relating to individual debt enforcement through judgment and repossession are set out in Chapter 6 (Part C) of the NCA,

¹⁹¹ NCR Task Team on Debt Counselling (Sunday, July 10, 2011) Available on: <http://www.libertineconsultants.co.za/debt-counselling-news/debt-counselling-news/article/ncr-task-team-on-debt-counselling.html> [accessed: 27-01-2012].

¹⁹² NCA, § 88(3).

debt review debars a creditor from enforcing these. The only available alternative outside of the debt re-arrangement procedure for a secured creditor with encumbered collateral is to enter a consolidation agreement with the debtor.

Both the Japanese and U.S. laws (and those in most of Europe) provide for the right of separation – secured creditors are allowed to exercise their security rights out of the insolvency process. The requirements vary a great deal. In the case of Japan, even when the temporary stay is in place or after the commencement of proceedings, these security rights cannot be extinguished¹⁹³ and only those secured claims for which payment cannot be covered by the collateral at hand may be exercised as insolvency claims (i.e., where the total amount of debts outstanding exceeds the value of collateral).¹⁹⁴ Under the U.S. system, a debtor has three choices with secured creditors: to surrender the property that secures the debt; reaffirmation of the debt; or redemption. However, Chapter 13 debtors may be given an option to pay the debt within the repayment plan, albeit under different conditions. In most of Europe secured debts like mortgages are left out of the process completely, and the principal debt cannot be included in the repayment plan.

6.8.5 Length of process

The length of time insolvent debtors are supposed to stay in the process is an important aspect of the over-indebtedness relief regulatory arrangement. Given the many restrictions imposed on such debtors, a much longer period might be received as a punitive measure but one which allows debtors to appreciate the burden of bankruptcy so that they be deterred from using it as the solution first resort. A shorter period, on the other hand, is meant to afford expedited rehabilitation for debtors so that they can be able to get on with normal life quickly and not be constrained for a long period.

The South African system does not regulate any time limitation upon the insolvency process and the resultant repayment plans. Under South African law, conclusion of the re-arrangement plan or order depends on fulfillment of all the provisions of that plan with the

¹⁹³ Civil rehabilitation Act, Art. 53; the Bankruptcy Act, Art. 65, § 1.

¹⁹⁴ Civil Rehabilitation Act, Art. 88.

consequence that they can go on indefinitely just as long the debtor continues to pay toward the plan. With regards to the U.S. (under Chapter 7) and Japanese liquidation procedure, once the available non-exempt assets have been sold, the debtor will be discharged from any other dischargeable debts and the process will be closed. The U.S.'s Chapter 13 and the rehabilitation procedure, require the plan payment to run for three to five years; after which the debtor will be discharged of all unpaid dischargeable debts. For most of Europe this period runs between seven years for the more restrictive systems to as little as 12 months for the more liberal.

The absence of limitations on the process has the risk that debtors' financial distress may be exacerbated as they will be tied up in the process and unable to access new credit during the period. On the other hand, some debtors may use the process as a means to hide from their obligations whilst creditors may not be able to recoup any meaningful value from the small payments that take forever. Indeed, according to Van Heerden and Coetzee (2011) such problems are already starting to appear in South Africa where some consumers are able to stay under the protection of the debt review process indefinitely, just as long as they continue making periodic payments towards the repayment plan.

6.8.6 Discharge

While the overarching goal of all these consumer bankruptcy systems is to provide for some form of relief and rehabilitation to over-burdened consumers, there are differences both in approach and application when it comes to discharge from residual debt. The South African law does not provide for a straight forward discharge of debt – at least not in the way foreseen by the fresh start doctrine. Relief is only provided through the restructuring of rights and obligations under the credit agreements in question. Automatic discharge is only contemplated if the debts in question resulted from reckless credit or if the creditors voluntarily decides to drop their claims.

Under the Japanese and U.S. laws, and most of Europe (except Ireland where discharge is left at the discretion of the High Court – but a debtor is relieved after 12 years) discharge is the implicit purpose for admission to insolvency proceedings as debtors are presumed to

apply for discharge upon application for commencement of proceedings.¹⁹⁵ Also, in most of these systems the outcomes of the process are more predictable at the onset. The debtor will know all his/her rights and obligations beforehand and so discharge is foreseen upon fulfilment of the requirements barring certain exceptions. In some cases, immediate and automatic discharge is foreseen (e.g., in most Chapter 7 cases without non-exempt assets).

6.8.7 Insolvency claims

Under the South African system, insolvency claims are not prioritised. All creditors' claims (both secured and unsecured) in place at the time of admission to proceedings will be admitted as insolvency claims and equal treatment shall be given to all claims under the re-arrangement plan. The costs of proceedings do not constitute insolvency claims and are borne by the state, except for the debt counsellor's fee.

The Japanese and U.S. systems provide for the prioritisation of insolvency claims and under the law all costs related to the proceedings are considered part of insolvency claims and are classified among superior claims and will be paid fully.¹⁹⁶ Claims such as alimony, child support payments, taxes, wages and salaries shall take precedence before any others. In Japan, the court may make an order to suspend or conclude proceedings if the available resources are only enough to pay for administrative claims related to proceedings.¹⁹⁷ In both systems, secured claims such as mortgages will be paid fully if the debtor is to keep the encumbered property. The other claims are the general unsecured claims incurred prior to the commencement of proceedings which are paid equally, depending on the residual income after the payment of superior claims.

In summations, as consumer credit increases in South Africa and other countries (both developed and developing) and crises and rising costs of living continue to affect societies in these countries, social policies will continue to converge towards common goals. With regards to consumer bankruptcy regulations, the common goal is one of providing a safety

¹⁹⁵ Bankruptcy Act, Art. 248.

¹⁹⁶ These include, but are not limited to expenses related to the trial, expenses of the trustee or supervisor and claims related to administration, realization, and liquidating distribution of the insolvent estate.

¹⁹⁷ Bankruptcy Act, Art. 148.

net for families whose financial positions have been damaged by unfortunate circumstances. The differences between the South African approach to debt relief and those of the other countries discussed above might be explained by the path dependence of institutions in some cases or the political influence of interest groups in others. Issues like the level of development of the markets, the general level of economic development and standards of living. Cultural differences can be argued as well. However, one needs to be especially sceptical with the cultural difference argument when dealing with consumer debt problems because as markets grow, consumer behaviour, consumption trends and influences tends to become similar. Issues such as conspicuous consumption and other excesses are common to all credit societies, but it is highly unlikely that any government will implement such far-reaching safety nets to aid people who encounter financial problems because they bought gold watches or diamond earrings.

Consumer bankruptcy relief measures are implemented because many unfortunate consumers suffer financial ruin as they try to make ends meet and hence need the protection. The submission here is that, while the influential interest groups in South Africa (e.g., COSATU, SACP) either were only interested in quick fixes like credit amnesties or they didn't know any better, the fact is, they overlooked the modern way of solving debt distress. Institutions like COSATU would know that it is in the interest of both the working poor and subprime lenders to transplant the pure fresh start approach into the South African regulatory framework. The results of empirical study of default risk (over-indebtedness) conducted for this dissertation suggest that the fresh start approach is required in the South Africa as much as it is in the developed countries, perhaps even more so – giving regard to the differences in context of course. Transplanting legal solutions from a developed world context might be advantageous in the South African context, as it might bring about important economic and, possibly, cultural change. After all, a substantial part of the NCA was transplanted from these countries (especially the 'preventive' side of the legislation).

6.9 Discussion

It should be noted at the onset that (first of all) states implement legal consumer debt relief measures to protect consumers because they realise that consumer debt problems often result from unfortunate events over which many consumers have no control (e.g., job losses, business failure, illness, divorces), or which are not of their own making (e.g., rising interest rates, falling property valuation). They realise, further, that over-indebtedness has many negative consequences on the individual, family, society and even the state. Also, if a person who has lost the capacity to repay his debt and has no immediate prospects of paying those dates in the foreseeable future were to be left at the mercy of debtors, it would lead to far worse outcomes for himself and his family. Second, debt problems may also result from irrational market behaviours including predatory lending, misuse of the debt instrument by consumers or generally poor money management. Governments intervene in such cases by implementing pre-contractual preventive measures (e.g., enforcing information and disclosure). The former is the subject of the current discussion while latter was presented in Chapter 2.

On the basis of social and economic considerations, experiences have shown that it is not always enough only to develop solutions that prevent debt problems from occurring, but solutions for alleviating those problems are equally important because debt problems will occur in spite of the best efforts to prevent them. This has led to a re-examination of the importance of having consumer insolvency laws. For many years insolvency legislations (except in the U.S.) completely favoured creditors and were synonymous with demanding payment and harshly punishing defaulters. As law-makers come to grips with the realities of the damaging effects and the causes of over-indebtedness, they have gradually revisited their insolvency regimes and directed them towards more consumer-friendly procedures. Although the connotations of punishment, ridicule and forcing repayment might still endure today, modern approaches emphasise finding the best avenues for permanent exit from debt distress and financial recovery: hence the ‘fresh start’.

Recent developments in this regard speak to the ‘earned’ fresh start in the sense that relief will require some effort on the part of the unfortunate consumer. The earned fresh start concept is built on two principle: the consumer’s right to a relief (given the unfortunate nature of over-indebtedness) and the creditors’ right to repayment (to the extent that there are some resources available to do so). While modern regulatory regimes largely embrace these principles, rescuing the unfortunate debtor (acting in good faith) is the overriding objective. The material aspects of many of the regimes differ considerably.

South Africa is one of several countries that has only recently introduced legal relief procedures for individual over-indebtedness and implemented measures which attempt to find a balance between recuperating value for the creditors and protecting the over-indebted consumer’s welfare from further deterioration. Salient features which speak to the philosophy of good faith are evident in this regime too. The law demands that insolvent debtors exhibit responsible conduct, make lifestyle changes, and meaningful attempts to pay back the debts while, consumers will be absolved of credit contracts found to be reckless. In general, the South African system recognises the idea that consumers have a duty to satisfy their obligations but due to some misfortunes, they are unable to do so and would appreciate an opportunity to revive their repayment capabilities where possible other than subjecting them to punitive actions.

The issue of deserts for relief is also well articulated in the debt review process. Relief is only reserved for ‘over-indebted’ consumers or those facing a prospect of becoming over-indebted in the near future, based on their obligations, resources and prospects. The role of debt counsellors in the debt review process, notably in the determination of over-indebtedness and renegotiating debts, is fundamentally important. Accordingly, debt counsellors must meet certain requirements for education, experience and competence. These attractive features make the current South African consumer debt relief regulatory framework a great improvement on any other similar laws, past and present. However given the many gaps in the legislation, one may well ask: whether the current measures are up to the challenge of providing meaningful debt relief and rehabilitation for consumers facing unmanageable debt?

6.9.1 Is the debt review process up to its task?

As has been mentioned earlier, the introduction of the debt review and re-arrangement provisions of the NCA was in response to the perceived inability of the laws in place at the time to provide relief and rehabilitation of over-indebted consumers. Indeed, the policy document that provided policy direction to the NCA stated in no uncertain terms that the mechanisms that were in place were not adequate to promote the rehabilitation of consumers, or even to assist already over-indebted consumers to deal with their debt, and that called for a review of those mechanisms (dti, 2004b:13). This was in reference to the insolvency law of 1936 in general and sequestration in particular, including certain provisions of the Magistrates Court Act of 1944. Although in terms of consumer protection, the debt review provisions are an improvement on these measures, it is this dissertation's submission that the debt review and restructuring processes are not equal to the task of providing meaningful relief and rehabilitation of consumer over-indebtedness. The issues that influence this conviction relate in general to the presence of overlapping procedures; absence of comprehensive legislation in some area, and lack of clarity on key issues.

6.9.1.1 Overlapping procedures

As was the case before the introduction of the NCA, the South African consumer insolvency regime allows for overlapping procedures. The NCA clearly states that it does not limit, amend, repeal any laws other than those specifically mentioned (§ 2(7)), and both the Insolvency Act and the Magistrates' Courts Act are not limited, amended or repealed by the provisions of the NCA. Debtors who are unable to pay their debts may still be pursued (and are still being pursued) for payment under the sequestration (voluntary surrender or compulsory sequestration) law which is governed by the Insolvency Act, or may be committed to administration orders which are governed by section 74 of the Magistrates' Courts Act. It should be noted that it is not a primary object of either the Insolvency Act or section 74 of the Magistrates' Courts Act to grant debt relief to debtors (Boraine & Van Heerden; 2010). Both procedures were designed with the main purpose of pursuing repayment and distribution to the respective creditors. Under these, the debtor's situation is

of no consequence and therefore the declaration of over-indebtedness is not considered.¹⁹⁸ In essence, these are creditor-oriented and therefore, creditors will find it profitable to file under one of these at the slightest sign of financial trouble knowing that debts under litigation cannot be included in a re-arrangement plan.

Also, business insolvencies are dealt with under these two procedures, making them unsuitable for individual consumers or households. In fact, their limitations in the context of consumer protection explain in part why the consumer debt review process was introduced. It is also highly unlikely that the provisions of the NCA will override the conflicting provisions of the Insolvency Act as no mention of this can be found throughout the NCA.

It is submitted that the multiplicity of laws and procedures presents various potentials for opportunistic behaviours. Notably, creditors have been reported to rush to apply more creditor-friendly proceedings even before notifying the debtors concerned, sometimes even before the ability to pay is completely lost. For example, creditors are known to rush to file emoluments attachment orders and place debit orders on consumers' wages, thereby making their family lives unsustainable as they often end up with barely enough to survive on, which often extends the debt-cycle and other adverse outcomes for the consumer (Haupt et al., 2008; James, 2013). The presence of multiple procedures may also reduce incentives for negotiations between debtors and their creditors. Even where over-burdened debtors approach their creditors for an amicable settlement, creditors might find it in their best interests to reject such advances knowing they can recuperate more through an attachment order. In a nutshell, the NCA's proclamation that it does not limit, amend, repeal any laws not specifically mentioned (§ 2(7)) is a giant loophole that is being exploited to further deny the debt review provision the ability to provide relief to consumers.

6.9.1.2 Inadequate legislation

Orderly and effective consumer insolvency procedures play a critical role in the prevention and resolution of financial crises, both at the household level and the macro-level, and may

¹⁹⁸ Under the administrative order, debts must be paid in full with interest without reference to a specific timeframe; administrators and fees are unregulated and there is no clearly defined property exemption under sequestration procedure to the effect that debtors may be left with barely enough to survive on.

even foster growth and competitiveness if the conditions are right (IMF, 2000). Tightly regulated procedures induce greater caution in the acceptance of liabilities by debtors, and influences greater confidence among creditors when extending credit or rescheduling their claims. The opposite may be the case when the procedures are inadequate and the results unpredictable.

It is the submission of this dissertation that the South African debt review and adjustment provisions are inadequate in terms of substance, process and application. The NCA does not provide for a comprehensive, integrated and standardised system for consumer debt relief and rehabilitation, as has become best-practice for consumer bankruptcy regimes around the world. In addition to the foregoing problems of overlapping procedures, the law does not define a fixed process with respect to the recuperation of claims and discharge. The insolvency plan (re-arrangement order) under the regime¹⁹⁹ is not standardised in terms of the amount of assets to be realised and the defined limits for exempt assets and minimum portion of the debt to be repaid. In essence, the rights and responsibilities of debtors and creditors are not clearly spelt out under the debt review, except that the courts and the supporting institutions are left with a lot of leverage to decide most matters at their own discretion, with the risk that similar cases under different proceedings will get different outcomes. Also, an incentive problem for potential filers may result from the lack of specificity on overall rights and responsibilities of parties. Considering that some consumers might be more adversely affected by over-indebtedness than others, the most vulnerable ones are most likely to lose out.

In the debt review process, the NCA and regulations are silent on how debtors are supposed to repay under the re-arrangement order. No directives on whether over-indebted debtors should repay the re-arranged debts using future incomes or by liquidating their assets, and how debtors' activity in respect of their assets should be handled. It is clear that many debtors subjected to the process will not own any assets or have any meaningful income prospects.

¹⁹⁹Re-arrangement plan (NCA); rehabilitation plan (Civil Rehabilitation Act) and the liquidation plan (Bankruptcy Act).

With such debtors, restructuring payments would be a futile exercise. Debtors are also likely to accept restructuring plans that they know they will not be able to fulfil if this will give them momentary relief.

Without clear guidelines in respect of the means to repay the re-organised obligations, confidence in the system will be lost. For instance, in the American system debtors with income prospects will accept a Chapter 13 arrangements with full knowledge that they can pay from future incomes and save their assets while, debtor with little or no meaningful income prospects but some assets will accept a Chapter 7 knowing that they can part with some of these assets and/or be discharged straight away.

On the specific issue of discharge, the NCA or its regulations does not foresee a straightforward form of discharge and release from the debt-burden. While relief and rehabilitation are important pronounced objectives of the debt review process, the law only provides for a re-arrangement of credit agreements based on a plan that enables the debtor to repay the debt on terms creditors are willing to accept or enforced by court. In practice, creditors are often unwilling to accept the terms on the table and in many cases, debtors find themselves with re-arrangement plans or orders they cannot fulfil without significantly hurting their families' welfare.

The submission in this respect is that the absence of a simple, clear and straightforward debtor discharge mechanism will perpetuate the debtors' over-indebtedness. This is because debtors will remain encumbered for a long time while trying to repay the rearranged obligations (with interest and debt counsellors' monthly fees) without enough or any resources to do so, and the possibility of attaining a real fresh start or rehabilitation may never be achieved – unless their financial situations improve remarkably or they are able to acquire some fortune. This point is underpinned by the fact that the factors that lead many debtors into this situation often have permanent effects or leave them with barely any resources to survive on, given that not many South Africans are able to muster even the modest precautionary savings. It is submitted, further, that the absence of a foreseeable form of discharge under the debt review provision makes the statement that this provision of the law offers 'rehabilitation' to over-

indebtedness very curious at best, and is the clearest indication that these interventions are not up to the task of providing what they set out to provide.

6.9.1.3 Lack of clarity on important issues

It is always important for individuals who contemplate using any legal procedures to know what is expected of them and what they will achieve in return – the same is true for those seeking legal consumer debt review. Given all the costs associated with legal debt-relief procedures, including the significant interferences in the legal and economic positions of debtors and creditors, initiation of the process should be subject to clearly defined outcomes and responsibilities so that candidates can judge for themselves whether these are compelling enough to justify such costs and interferences. The IMF (1999) states that without an effective procedure that is applied in a predictable manner, creditors may be unable to collect on their claims which will adversely affect the future availability of credit. Without orderly procedures, the rights of debtors may not be adequately protected and different creditors may not be treated equitably.

One of the important issues not clarified under the NCA is time limitation on the debt review process. While the Act provides grounds for closing of proceedings, there is no regulation on how long the proceedings should last or how long the debtor must be subjected to the re-arrangement plan, and the maximum length of time for extending payments. The law in its current state suggests that a re-arrangement order will stay in place indefinitely pending fulfilment of the provisions therein. While it is possible that a fixed-period plan payment might distort the debtor's ex-post incentives to work hard (Bigus & Steiger, 2006), it is also possible that debtors will drag their feet in executing an indefinite repayment plan. Restructuring plans that run unusually long do not only damage creditors' positions (as they may not be able to recuperate meaningful value from the small payments that stretch over many years and cannot exercise their right to collateral), but also have a tendency to disadvantage debtors who might be kept longer under the shackles of bankruptcy, especially since a debtor is debarred from certain financial activities until the fulfilment of the restructuring order including restrictions on accessing new debt.

Another submission on this matter is that the provision for merely extending repayment periods (as a means of relief) may damage debtors' wellbeing rather than improve it. Debtors enter the debt review procedure because they are over-indebted and unable to continue repaying their debts. Extending their period of payment will not solve their over-indebtedness, it might simply increase it as they might try to borrow from other sources (often more dangerous underground sources) in order to fulfil the new payment requirements.

A few others shortcomings, both within the NCA in general and the debt review provision in particular, put over-indebted consumers in danger of not getting the relief they seek. Notable of these include the absence of the right of separate satisfaction which allows secured creditors to exercise their security rights out of the debt review process. If secured debts, like mortgages, are re-organised together with the other unsecured debts, the burden on the debtor under a re-arrangement plan will be huge and it may require years or decade to fulfil such a plan. Also, the debt counselling process is not well articulated in the Act and its regulations. Although debt counsellors are required to measure up to certain standards, problems still exist. Firstly, some of these standards are too low especially the requirement for a minimum education level of Grade 12 is quite disturbing. The other problem is the fact the law does not prescribe enough as to how debt counsellors shall do the job. In practice, reports suggest that the process has been affected by arbitrary standards for filing consent forms, engagement between debtors and creditors, debtors being misinformed by counsellor and profiteering by lawyers-turned debt counsellors.

In summation, the NCA through the debt review procedure and restructuring of credit agreements contemplates that over-indebted consumers will get relief and rehabilitation and, consequently, their financial health will be reclaimed. This dissertation submits that this provision in its current form is not able to meet such objectives due to the reasons discussed above. The tools provided cannot provide meaningful relief to over-indebted debtors but rather very limited relief to some consumers who have the ability to repay the restructured claims. Without a straightforward form of discharge, those who enter the process may even find their over-indebtedness situation getting worse because over-indebtedness means an

inability to continue repaying debts (and it is defined as so in the NCA), however, simply rearranging insolvent obligations, extending the payment period, or recalculating the interest and fees does not change this situation much – if at all. For instance, simply extending the period of repayment for a person who just lost a job with no prospect of getting another soon would be a futile exercise. In addition, the lack of clarity on many matter of importance takes the process away from the consumers as it will mean that judges will use discretion on most matters yet this being new to South Africa, the only precedents available to them will be those from the Insolvency Act and Magistrates' Courts Act which are overly creditor-friendly. One cannot go far in solving consumer debt problems (especially in an environment of wide-spread idiosyncratic shocks) 'based on the principle of satisfaction by the consumer of all responsible financial obligations'.

6.9.2 Policy recommendations

The issues presented above present a strong argument for a more thorough review of the NCA's debt review and re-arrangement procedures. In the context of consumer protection, harmonised statutory debt relief procedures which speak to a balance between creditor and debtor interests are required. The idea is to ensure that the regulatory reviews take stock of recent development in the modern world with regards to dealing with debt problems of individuals; the causes of these problems; the efficacy of current measures in providing relief and rehabilitation; and the individual and social effects of over-indebtedness. In that way, measures that are equal to the task of providing a real fresh start for individual debtors while minimising prospects for abuse and distortion can be forthcoming. The Commission on International Trade Law's (UNCITRAL) Legislative Guide on Insolvency Law²⁰⁰ suggested standards for global best practice which speak to achieving a balance between the four basic aspects of post-contractual regulatory intervention: relief; rehabilitation; repayment of creditor claims; prevention of abuse and efficiency of the process. To a larger extent, modern states with fresh start debtor relief procedures have incorporated these goals. While the material aspects might differ, states recognise that the only way to relieve debt problems of

²⁰⁰The World Bank (2011). 'Principles for effective insolvency and creditor/debtor regimes' (Revised). Available on: http://siteresources.worldbank.org/INTGILD/Resources/ICRPrinciples_Jan2011.pdf [accessed: 20/08/2012].

individuals is through simple, accessible procedures where both credit providers and debtors recognise their responsibilities and the importance of a functioning credit market.

It has been suggested earlier that South African consumers deserve debt relief and rehabilitation measures that speak to the ideals of the fresh start perhaps even more than those in states that have them. In these states, legislators justify these provisions by recognizing the importance of unfortunate events (beyond a consumer's control) in consumer debt problems. The empirical results in this dissertation on the cause of over-indebtedness speak accordingly. The other justification is that individual consumers cannot be left to deal with the debt distress on their own as this can have damaging consequences on their dependents, society and the credit market at large and on the basis of economic, social and moral consideration, it requires a collective arrangement with considerable political effort. Legislators in South Africa made the same arguments (although not in the precise words) when the current credit law was being considered and they still do.

Against this background, in order to achieve debt relief measure that will provide meaningful relief and rehabilitation of debtors, a comprehensive review of the consumer insolvency system is required to provide a simple and straightforward mechanisms for debt discharge. With regards to the policy, the idea of an unfortunate debtor who acts with honesty and in good faith should be given special consideration. The rehabilitation should result from partial payment of the debt to the extent possible (using a portion of available and future resources if any) and eventual discharge (fresh start) after a specific period of time. Such a system should be able to preclude debtors whose debt problems resulted from gross mismanagement of credit, and remove incentives to use the procedure as a solution of first resort. Hence, strike a balance between the relief as a 'favour' to those who act in good faith and a 'right' for the masses who suffer with unmanageable debt. More specifically:

- Discharge should be exclusive and definitive, giving regard to the adherence to the terms and conditions. Only compelling reasons behind the debtor's over-indebtedness should warrant admission to the procedure and evidence of the debtor's efforts to repay or inability thereof should be required.

- The discharge should follow a specified period of good conduct which should ideally be between 12 months and three years – long enough to allow time for repayment efforts and adjustment of behaviour and not too long, so that debtors can exit relatively early to embark on rebuilding their financial lives.
- The terms of the discharge should be specific and simple. The rights and responsibilities of each party should be spelt out in simple and precise terms in the regulations. This should help build confidence in the process and reduce conflict of law.
- Alternative measures for those who, for some reason, are unable to get a discharge should be clearly stated. If an appeal is provided for, grounds and procedures thereof should be clarified.

With regards to repayment, the scope of assets and repayment plan should be clear. It is vital that the terms and provisions of the repayment plan are clearly spelt out in the Act or regulations to the extent that they are predictable and discernible so that debtors or creditors will enter the process with full knowledge of the costs and possible gains. The law should provide for liquidation of assets (if any are available) so that debtors may enjoy early release from the process. The law should authorise any sale that maximises the value of the assets being liquidated, the most convenient and cost-effective means of sales (e.g., public auctions or private sales), and both creditors and debtors may be able to propose any other means that will fetch more value and are easy and quick to implement, with the requirement that the sale is supervised by the interested parties.

- The proportion of resources (i.e., property and future income) to be set aside for repayment should be clarified and this should be fair enough to represent a meaningful contribution to the debt repayment.
- The proportion and type of exempt assets should be clarified and this should be fair enough for debtors and their dependents to live a minimally acceptable standard of living (which should be clearly defined in the regulations).

- Measures to deal with no-income/no-asset debtors or those debtors whose income and assets are too low to represent meaningful payment should be introduced. Such debtors should be enabled to discharge their debts expediently, either without any further action or after a short period of community service.
- Secured creditors should be allowed to exercise their security interests outside the debt review process or secured credit (e.g., mortgages) should be eliminated from the provisions of the debt review altogether.

With regards to the goals of prevention of abuse and efficiency, a comprehensive system for consumer bankruptcy is necessary with amendments to standardise the form and manner of proceedings as well as to iron out ambiguities. Possible abuses should be clarified and provisions to prevent them should be effected so that debtors will not use the insolvency process as a cover for their dishonesty; attorneys will not use the process for profiteering and lenders will not abuse debtor's ignorance of their rights and the law, while the process should be made accessible to those who badly need it.

- It is necessary to introduce tools that will enable earlier commencement of the proceedings, when there is still value for creditors and debtors to rescue and/or not have to wait until the debtor is irreversibly destitute.
- The prevention of abuse calls for a facts-sensitive test of over-indebtedness and future repayment capacity: currently, there are no clear boundaries for the debtors' resources, prospects and obligation.
- Efficiency calls for unified and harmonised insolvency procedures where liquidation and rehabilitation represent the different possibilities or steps of a uniform consumer debt restructuring law. Specifically, sequestration and administration orders in respect of natural persons should be repealed in favour of a uniform debt- adjustment procedure under the NCA.

- With regards to the types of debt falling under the NCA, the NCA should be able to override any other laws (notably, Insolvency Act and Magistrates' Courts Act), with a precisely worded clause to that effect.

Legislators should evaluate ways to minimise the role of courts and the need to pay for the service. This should help to expedite the process, reduce case backlogs and profiteering by interested parties. Most debtors admitted to the insolvency procedures are usually in a very poor financial state and may be unable to meet even the modest fees while a long unwieldy process may make their rehabilitation untenable.

- It should be useful to adopt integrated amicable out-of-court settlements. Indeed, in many countries, out-of-court proceedings (either supervised or not) are considered a pre-bankruptcy alternative that tries to avoid lengthy litigation processes. While the debt counsellor is empowered to recommend out-of-court negotiations, these are not regulated by the NCA. Attempts at out-of-court settlement should be made a prerequisite for admission; only when these have been tried and failed should the case be admitted formally.
- State-sponsored local agencies, especially professionals and paralegals, stationed at municipalities should be given a central role in the consumer debt-adjustment process. This should make the process more accessible whilst eliminating the financial cost to debtors.
- Also post-insolvency debtors should not be left to their own devices otherwise they might regress. Mechanisms for post-insolvency debtor education and counseling should be regulated to enable full rehabilitation of debtors. Post-insolvency monitoring to prevent possible repeat filing should be implemented. Local state sponsored agencies and agents are better positioned than courts and lawyers to play these roles.

6.10 Conclusion

Previous chapters showed that unanticipated socio-economic shocks (over which a consumer or lender has no control) explain more of the over-indebtedness problems of South Africans than reckless borrowing to fuel excessive consumption. This strengthens the argument for the adoption and implementation of more consumer-friendly debt relief and rehabilitation measures (within a tightly regulated framework). The fact that policymakers emphasised (during the consideration of the NCA and subsequently) the negative effects of over-indebtedness to family and society, underscores the necessity for further reform. In countries where the ‘fresh start’ regulatory intervention is an established law, policymakers and other observers mostly relied on the same two arguments to justify the necessity for those measures.

In addition, in light of the causes and consequences of consumer over-indebtedness: contexts like South Africa where socio-economic shocks are widespread and in some cases have permanent effects, the need for measures that offer comprehensive debt relief and rehabilitation has never been greater. In fact, it can be argued that the fresh start for individual debtors is even more relevant in such contexts than it is in the developed world contexts, simply because in contexts like South Africa where households are mostly unable to afford even the modest financial buffers, the effects of over-indebtedness can be more devastating if the victims are not offered a meaningful helping hand. In a nutshell, South African consumers – given their high levels of risk exposure – deserve legal provisions that offer debt discharge when they lose all prospects of repayment. The first objective should be to offer the consumers an opportunity to reclaim their financial health so that they may continue to live economically productive lives with the second objective being to explore possibilities for repayment (to the extent possible) – the order of objectives should be important.

Of course some might be sceptical as to whether a fresh start system is a viable option in a context in which shocks have longer-lasting effects (e.g., if the debtor is going to be unemployed for years). However one should also consider that, firstly, it is also not a viable option to leave such a debtor at the mercy of creditors who want repayment at all costs. In fact, it is much more dangerous, and on the basis of social and moral consideration, the state

has an obligation to intervene and relieve such an individual without any impediments. Secondly, it is no guarantee that all who get relief will reclaim their financial positions, but the idea is to offer a fighting ‘chance’ (i.e. opportunity).

One might also come across a query on whether the current political climate would allow for the fresh start idea. The submission here is that the political climate had never been more ideal for the implementation of these debt relief measures. It has been noted earlier that the differences in contemporary approaches to debt relief can be explained *inter alia* by the political influence of interest groups. The ANC government and its political allies (notably COSATU and SACP) have a strong predisposition to consumer protection in the credit market especially the wage earners and previously disadvantaged. These political entities have always motivated the need to offer some form redress to these groups (for past injustices by capitalistic lenders) which includes measures that seek to relieve them of their debt distress (which is blamed, to some extent, on the political and economic structures under apartheid) or the effects thereof on an on-going basis. Other influential Non-profit Organisations such as the Black Sash, FinMark Trust have always lobbied government for tightly regulated and more consumer-friendly relief measures.

In addition, the Public Service Commission and the NCR have issued reports that highlight the disturbing levels of indebtedness among salaried workers with the Public Service Commission highlighting causality between the over-indebtedness of public servants and financial misconduct. They note that the Garnishee orders and debit orders placed on over-indebted workers’ salaries exacerbate their financial distress. Also, pursuing the ‘fresh start’ will not require substantial financial and infrastructural investment as the framework is already in place and all that is required is galvanizing the necessary supporting institutions – no more than what is required even without an overhaul of the system.

The NCA contemplates providing debt relief to an over-burdened consumer but ‘based on the principle of satisfaction of all responsible financial obligations’ by the consumer. The submission here is that this statement effectively preempts the objective of relief and rehabilitation because the inability to satisfy ‘responsible financial obligations’ is the reason

debtors seek debt relief in the first place. The statement in effect make the debt review provisions creditor-oriented, although creditors continually say the opposite. Also as noted earlier, discharge is only reserved for reckless credit agreements which is also another indication that legislators downplayed the importance of shock in consumer over-indebtedness – which has been submitted as the possible reason for the NCA to downplay the importance of alleviation of over-indebtedness. Both preventive and alleviative objectives need to be given equal prominence.

Furthermore, the going problems of overlapping procedures (with their own considerable shortcomings), inadequate legislation and lack of procedural clarity on major issues prevent the NCA from providing meaningful relief and rehabilitation of over-indebted consumers and therefore a comprehensive review of the debt-review provisions is necessary in favour of a framework that provides a simple straightforward mechanism for debt discharge. The importance and severity of socio-economic shocks in South Africa make such measures all the more relevant because if a household should fail to repay debts due to the bread-winner becoming suddenly unemployed, with the possibility that he might go four years without finding a new job or a household bereft of the bread-winner (with HIV/AIDS playing havoc), it is less likely they will be able satisfy “all responsible financial obligations” – if any at all. A further submission is, the measures in place are likely to perpetuate the problem of over-indebtedness rather than reduce it, as only very limited relief is offered and only to those with the ability to repay. However, theory posits that in an ideal market, debtors will not abandon their consumer debt obligations unless their cash flows badly deteriorate that continuing to honour these obligations will cause undue strain on theirs and their families’ welfare – empirical findings speak according. Yet, there is no evidence to suggest that the South African market is less than ideal and that it will not be governed by the same principles.

Chapter 7: Summary and conclusions

7.1 Conclusions

The ‘life-cycle and the ‘ability to consume’ theories have played an important role in explaining the dynamics of consumer borrowing. First, it is postulated that consumers have their underlying plans for consumption over their life cycles. They borrow in order to tailor their consumption patterns to their needs at different ages, independently of their incomes at each age (Deaton, 2005). Second, borrowing patterns are also driven by objective factors, such as income and other resources that convince lenders that a particular consumer will be able to repay the debt when due. Realistically, the capacity to repay debt as and when it comes due cannot be predicted with certainty. Inevitably, some consumers face shortfalls in their anticipated incomes and consequently, their debt sustainability. For others, the lack of good information or poor financial management might result in unsustainable borrowing culminating into repayment delinquencies.

Given the importance of consumer debt to household wellbeing as well as the causes and possible consequences of over-indebtedness, regulatory interventions are necessary to protect consumers, by firstly aiding their decision-making and secondly, by providing them with consumption insurance if they find themselves hopelessly over-indebted. Such interventions speak to solutions that both address the causes of consumer debt problems (preventive regulations – i.e., information and credit terms disclosures, consumer education and illegalising reckless credit granting) and solutions that attempt to address the consequences of these problems (alleviative) within a framework for relief and rehabilitation. The new South African National Credit Act 34 of 2005 (NCA), is a comprehensive credit consumer protection legislation that encompasses all these tools and principles and on the basis of this, the NCA might be seen as measuring up favourably with the consumer credit legislations in the financially developed world.

This dissertation analysed consumer debt use in South Africa in terms of the regulatory framework (the NCA), patterns of participation in the consumer debt market, and the patterns and dynamics of the debt problems of individuals and households. The regulatory framework was analysed in the context of prevention of over-indebtedness in order to provide an understanding of whether the legislation is equal to this task.

Next, the dissertation adopted the life-cycle theory of consumption and the ‘ability to consume’ arguments, and analysed survey data to explain consumer debt use (in terms of incidence and level of indebtedness) across different households and individuals. This analysis attempted to shed light on the market behaviours prior to the NCA and the financial health of the South African household sector after the implementation of the NCA.

The dissertation then proceeded to analyse empirically the determinants of consumer debt repayment problems so as to elucidate what area of the regulatory framework (preventive or alleviative) might need extra attention going forward. The empirical results in Chapter 5 suggested that the post-contractual solutions to debt problems might need to be revisited as many debtors were experiencing debt problems due to factors beyond their control, and this contention was analysed in Chapter 6 against a background of developments in other countries.

Overall, the main goal of this study was to develop an understanding of nuances of consumer credit use in South Africa, giving regard to the laws that govern the relationships between the users and consumption patterns and the consequences that might result from the use of debt by certain types of consumer. The study finds evidence suggesting that while the dynamics of debt use are more complex than lenders’ and borrowers’ willingness to engage, consumption patterns and behaviors in South Africa are not unique, therefore, the credit market might benefit from an increased adoption of the international standards for best practice in consumer credit regulation.

7.1.1 The NCA in the context of preventing over-indebtedness

The main purposes of the NCA is to protect consumers by, inter alia, promoting responsibility in the credit market, discouraging reckless credit granting by credit providers and ultimately

preventing consumer over-indebtedness. Measures that, inter alia, improve consumer education, information disclosure as well as illegalise reckless credit extension were deemed crucial in achieving these objectives.

As presented in subsection 2.3, that was a response to perceived weaknesses in the regulatory environment (e.g., lack of or inconsistencies in enforcement, poor information disclosure, deceptive credit market, a dual market, etc.), the government introduced the NCA as a consolidated national consumer credit legislation with tools to tackle reckless credit granting and to improve the bargaining position of consumers. Based on current policy debates and developments in this area, these tools make the NCA a revolutionary piece of legislation in the context of prevention of consumer over-indebtedness.

7.1.1.1 The key components of the Act

The key components of the Act that reflect its objective of ‘prevention’ of over-indebtedness include the following:

- **The NCR and the registration requirement**

Registration is intended to enforce responsible market behaviours and eliminate underground activities and impunity. A single regulator also eliminates operational overlap and inconsistent application of the law. In practice however, the NCR’s extensive mandate, has affected its enforcement capacity and, resulted in a lack of compliance monitoring.

- **Disclosure and information sharing**

Disclosure and information provisions entails exhaustive disclosure of credit terms and information by lenders to consumers to enable them to make their decisions in full knowledge of the facts so that they are unlikely to over-burden themselves with debts they cannot afford. Lenders are also enabled to exchange borrowers’ information seamlessly in order to determine risk more efficiently and cost-effectively. However, these outcomes might be impeded by the inadequate compliance monitoring.

- **Reckless lending and over-indebtedness**

This provision obliges lenders to make thorough financial assessments of credit applicants to determine the extent of their indebtedness, the maximum amount of credit they can afford and their knowledge of the risks and responsibilities before accepting credit applications. A failure to conduct these assessments or a disregard of the negative results thereof, renders a lender guilty of entering into a reckless credit agreement.

- **Consumer education**

The NCR is tasked with promoting public awareness campaigns to educate consumers about consumer credit matters and the Act's provisions, including consumer rights and responsibilities in credit relationships, and most importantly, the risks involved in these relationships. Consumer education and public awareness is thus a very important complement to all provisions that directly relate to the consumer decision-making.

7.1.1.2 Concluding remarks

The recent world financial crisis presents two important lessons for consumers and regulators. The first is that no matter the pressures to spend, one should stay within the limits of one's resources and obligations. The second is that easy access to credit is an incentive to become over-stretched and financially fragile. The days of unlimited consumer credit are almost coming to an end as consumers, creditors and policy-makers are beginning to appreciate the importance of shock on the overall financial health of the household sector. Tighter regulations on spending are now more desirable than ever before, while the importance of saving and other financial buffers cannot be overstated anymore. Whether these efforts will prevent future crises is still the question.

The NCA is a more extensive piece of consumer protection legislation than those it replaced and possibly more consumers will benefit from its provisions given that it reduces incentive to overspend. Against this background, it is this dissertation's submission that the NCA presents great promise in the context of the prevention of consumer over-indebtedness, and the principles behind the NCA's preventive tools compare favourably with standards in the financially developed world and are therefore necessary. For instance, the provisions on

registration, reckless credit, information and disclosure, and consumer education are well positioned to prevent abuse and predatory lending and, consequently, prevent unaffordable credit extension and use.

Over-indebtedness is tightly connected to many other aspects of wellbeing and therefore its prevention requires a more broad-based policy framework. Since many aspects of consumers' financial wellbeing may not fall within the ambit of the credit contracting and sale and therefore may not be covered by the NCA and NCR, other social policies and legislations cannot be allowed to take a backseat when it comes to matters of credit and consumption. Policies that speak to social welfare, personal saving and insurance, education and employment need to be tightened as well.

Nonetheless, many aspects in the NCA still require attention. The most notable of these include the lack of infrastructure for compliance monitoring at the time of entering credit agreements, delivery of consumer education, guidelines on how a court should exercise its discretion in judgments related to reckless lending, and monitoring compliance – especially at the time of entering credit agreements. Also, the fact that the law no longer prescribes a minimum deposit and a maximum period of payment, might remove incentives for consumers to think twice before making purchases.

7.1.2 Participation in the consumer debt market

It has been noted earlier that since the mid-1990s South Africa has experienced an unprecedented growth in consumer indebtedness, both in terms of value of debt held and number of households having access to credit. This growth has been attributed largely to the regulatory environment which changed dynamically the conditions affecting the supply of credit (Aron & Muelbauer, 2000) and the social-political changes that the country has gone through since 1994 which affected the demand of credit (Hurwitz & Luiz, 2007). The wide-ranging problems that ensued from these changes necessitated the introduction of the NCA as a direct response to these problems. This dissertation analysed consumer borrowing patterns prior to and after the introduction of the NCA. The aim was to make inferences on

the market behaviours during the two periods, as well as elucidate the financial health of the household sector.

Chapter 3 of the dissertation analysed the factors behind the ‘incidence’ of consumer indebtedness prior to the introduction of the NCA. It is widely reported that due to under regulation, reckless credit practices were rife which, might suggest that the drivers of credit participation (e.g., creditworthiness) might be different from what has been discovered in the well regulated markets. The analysis in this chapter investigated whether this might have been the case. Under Chapter 4, the investigation focused on the distribution of consumer debt (in terms of amounts owed) after the implementation of the NCA. The aim was to inform on the borrowing behaviours and financial health of the household sector given the existence of a new comprehensive credit regulatory regime.

7.1.2.1 Incidence of indebtedness

The literature review led to the conclusion that consumer debtors are more likely to be found in certain types of households than others because, due to lenders’ aversion to loss, the ability to borrow will differ across households. The results of the analysis of South African data spoke accordingly. In Chapter 3, this dissertation utilised data from the Cape Area Panel Study (CAPS) to analyse the incidence of indebtedness among South African households prior to the introduction of the NCA in order to determine whether lenders adhered to responsible lending practices even in the absence of proper regulation – knowing that deviating from this will be inviting default losses for lenders. Specifically, whether a household’s creditworthiness (capacity-to-borrow) was an important factor in the distribution of consumer debt. The effects of consumption needs were also analysed to investigate whether the micro-economic objective might be lost on an under-regulated market.

However, the logistic regression analysis identifies that – as previous studies had shown – consumer debtors were more likely to be found in households with higher per capita income; those who held financial assets; and those who held positive perceptions of their financial situations. This picture is in line with the ‘ability to borrow’ hypothesis and might imply that credit was more likely to go to households which had the capacity to repay. Homeownership

was negatively associated with consumer debt use, possibly due to the fact that both the rich and the poor can be homeowners (even if they are shack or RDP houses).

The logistic regression analysis also showed that – *ceteris paribus* – the probability of holding consumer debt increased with the level household expenditure; household size; having dependent children; the age of the household head; and if the household head was married. This implies that (other factors constant), these households might have been forced to use consumer debt to smooth consumption on a background of expenditure pressures resulting from these situations. Such are considered optimal household behaviours consistent with the life-cycle theory of consumption, but blur the boundary between responsible and irresponsible borrowing. All in all, these results suggest that the government might have overemphasised reckless credit behaviours in making the case for the current regulatory regime.

7.1.2.2 Level of indebtedness

Just as with the incidence of indebtedness, many previous studies have arrived at a consensus that consumer debt levels will be affected by factors related to the ability to borrow (creditworthiness) and the needs of the consumer. If lenders behave rationally, they will choose borrowers with quantifiable ability to repay and these will be found to hold larger outstanding debts, but their debt-service ratios are likely be lower because they are more likely to maintain their repayment accounts regularly – controlling for occurrence of adverse shocks. For other consumers, the level of debt is likely to be explained by the need to make ends meet, especially due to heavy dependencies on the available resources or when they encounter adverse events. This dissertation supported this consideration based on discoveries elucidated in Chapter 4.

Using the National Income Dynamics Study (NIDS), Chapter 4 projects that lenders' trust in the viability of a consumer's resources; changing demands on the a consumer's resources resulting from the consumer's position in the life-cycle and other economic pressures; and the consumer's own financial expectations, may be especially crucial in explaining how much borrowing will be undertaken.

The preliminary findings demonstrated that the distribution of debt both in absolute terms and in terms of the debt-service ratio was so asymmetrical that the normal distribution assumption does not hold up. This means that while a big proportion of the consumers may have kept their indebtedness levels low, there were a few who overextended themselves to unsustainable levels. Only a small portion of the sub-sample reported to be in debt (13%), and only 84 per cent of these reported having an outstanding debt. It is possible, however, that those who did not report an outstanding amount may have done so simply because they could not recall the amount rather than because of a refusal to give the amount. Given that a substantially larger part of the sample reported zero debt, the Tobit regression analysis was chosen to estimate the coefficients of the predictors of consumer indebtedness levels.

The multivariate analyses show that consumer debt outstanding was as hypothesised more likely to increase with income and education attainment. Both characteristics have been noted in the literature to increase lenders' trust in the borrower's capacity to repay. The number of commitments held – a direct measure of the ability to borrow – was also positively related to the outstanding debt. With regards to borrowers' consumption needs, only the results for marriage were as hypothesised. Married consumers were more likely to hold larger outstanding debts than their unmarried counterparts which might also relate to the consequences of family responsibilities. Experiencing a negative income shock or ill-health were negatively related to the size of the outstanding consumer debt which is sensible, given that these scenarios are likely to hinder one from qualifying for large amounts which keeps the overall debt levels low. Also, such consumers might make sacrifices to reduce their borrowing levels when they realise that they can no longer afford the required monthly installments. Contrary to the life-cycle theory postulations, age and optimistic financial expectations variables were not statistically significant.

With regard to the debt-service ratio, the resultant significant variables were a decrease in income; ill-health/disability; education; income; number of commitments; and total consumer outstanding debt. As had been hypothesised, consumers with higher incomes and higher education attainment were experiencing a lower debt repayment burden than the

lower-income consumers and those with lower education attainment – although these were associated with higher amounts of outstanding debt. The results for education are plausible, given that higher levels of educational attainment might influence rational decision-making and, possibly, borrowing caution. The size of outstanding debt and the number of commitments were, as hypothesised, positively related to the size of the debt-repayment burden. Consumers are more likely to miss instalment payments if they have heavy debt loads or hold more commitments and the compound interest and fees may lead to an inflation of their overall debt-service burden. Overall, the results, suggest that consumers with visible ability to borrow are less likely to hold heavy debt-burdens and this could be attributed to lenders' selection criteria, while holding larger amounts of outstanding debt is more likely to increase the debt-burden – even though it might be an indication of one's ability to borrow.

The findings in Chapter 4 also indicate that financially adverse situations contribute to a growth in the debt-service burden and consistent with the hypothesis. Adverse situations such as ill-health can be associated with extra costs (e.g., medical care), but can also mean a lower level of resources whilst, a negative income shock might trigger a debt-spiral. Overall, these results suggest that a consumer debt-service burden is more likely to increase if a consumer encounters situations that might negatively affect incomes which might either, result into a slowdown in repayments or increased borrowing.

7.1.2.3 Discussion

Tracking consumption patterns in the credit market is an important policy objective of the government. Chapters 3 and 4 of this dissertation attempt to contribute to literature in this regard by analysing the incidence and level of indebtedness. The incidence of consumer debt prior to the implementation of the NCA was the subject of Chapter 3. The period of interest was documented to be characterised by widespread reckless and predatory credit activities which might mean, among others, that many lenders were lending without proper creditworthiness evaluation. Vulnerable groups (such as consumers with low incomes or the unemployed) with lower credit ratings would also participate in borrowing as much the rest of the population – and sometimes even more – because their situations often demand more

borrowing. More specifically, the factors that suggest one's ability borrow (e.g., income and other characteristics that suggest creditworthiness) might not have been important in determining who was more likely to qualify for debt.

The results in Chapter 3 suggested that credit practices in an under regulated market are not very different from those in well regulated markets. Two findings resulted in this inference: first, the ability to pay was an important driver of lending – because lenders still have to protect themselves against default losses and second, emergencies influenced households borrow. The former seems in conflict with government's evaluation of the situation at the time and to downplay the importance regulatory interventions to restrict credit access. In the latter, the inference might be that regardless of the regulatory situation the credit market will satisfy its micro-economic objective – when confronted by new consumption obligations, for instance the arrival of new family members, households will use credit as consumption insurance. Consumer debt was more likely to be found in households with the capacity-to-service it, and those who had confidence in their financial health. Based on this evidence, it is the submission of this dissertation that reckless lending cannot be proven. But if (as noted in Chapter 2) a dual market existed, it is also possible the participation rates were underreported and the results might apply more to the 'other' well regulated market. The limitations of the data made it impossible to investigate this possibility. As such, these inferences might not be so binding.

The NCA was introduced to, inter alia, enforce responsible use of credit products. This entails observing optimal underwriting standards, so the largest amount of debt will go to consumers who are more likely to repay and, as a consequence, there will be lower probabilities of default. In addition, vulnerable groups may be able to access credit, but their debt load should not be allowed to get too high, so that should they fail to pay, the amounts would be small and not bidding enough to cause substantial disruptions in the credit system. The investigation in Chapter 4 found evidence of this, and might suggest that perhaps the NCA is on track to achieving its objectives. As such, it is this dissertation's submission that based

on this empirical evidence, the household sector seems to be relatively financially secure although there are pockets of vulnerability.

Regarding the vulnerabilities, some consumers were getting over-extended in their efforts to make ends meet or deal with unavoidable adverse changes in their circumstances. This dissertation submits further that in a market where social security is highly imperfect, where incomes are highly volatile for the greater portion of the population and with chronic under-saving, it is sensible that some consumers will get financially over-stretched – even without misusing debt. It is for this factor that legislations in many states and, indeed the NCA, provides for legal interventions to alleviate consumer debt problems. Based on this contention, the dissertation proceeded to analyse possible drivers of consumer debt problems.

7.1.3 Consumer debt repayment problems

As noted earlier, the NCA was enacted in response to the growing problem of consumer over-indebtedness with tools to ‘prevent’ as well ‘relieve’ consumer debt problems. Consumer debt problems can result from deficient market behaviours and from social situations beyond the control of the market and the design of contemporary legislation is highly sensitive to this. Chapter 5 of this dissertation examined what kind of consumer is more likely to experience repayment problems on a consumer debt. Overall, the main goals were to identify the main reasons behind households’ debt repayment difficulties, given, firstly, the negative consequences of arrears on the consumers and their dependents and, secondly, the fact that delinquencies continued to rise even in the presence of stronger regulatory regime. Based on the findings, the study was also intended to stimulate discussion on the current regulatory framework – and this necessitated the inclusion of Chapter 6.

7.1.3.1 Predictors of debt repayment problems

The dissertation employed data from the Cape Area Panel Study (CAPS) and adopted the cash-flow theory of default in the analysis of consumer debt delinquency. This theory is based on the assumption that debtors will avoid arrears as long as their income flows are sufficient to cover their debt payments without undue financial stress. As such, financial performance, and the level of consumption will be important factors in accounting for consumers’

repayment performances. Previous studies have concluded that adverse events (especially if they happen after a credit request has been accepted, for instance, loss of employment), are more likely to result in consumer debt payment problems. The importance of such events is amplified by the fact that both the lender and debtor may not be in a position to anticipate them at the time of entering a credit agreement and so might not be prepared for them. Other situations that exert extra pressure on family income (e.g., large families) have also been blamed on the basis of the assumption that they render families more disposed to unanticipated emergencies. Others have attributed delinquencies to excessive spending which renders households financially overstretched.

The analysis tested whether poor payment performance is better explained by overspending that leads consumers to over-burden themselves, or by financially adverse events which strain family resources and erode the repayment capacity. A selection of factors related to households' 'ability to borrow' were also included to control for the importance of lenders' selection criteria thus, allowing for the fact that some households are more likely to repay their debts than others (i.e., assuming that both delinquent and non-delinquent debtors were subjected to risk assessment processes).

The results of the logistic regression analysis indicated that households were more likely to be delinquent on their consumer debt obligations if they experienced, a decrease in income; increases in general household expenditure; and increases in family size. In addition, households that self-reported experiencing financial pressure, random negative events (e.g., illness, loss of employment) and those who had dependent children were more likely to be delinquent. These relationships held even when controlling for ability to borrow. These results were intuitive in relation to the assumptions of the cash-flow theory given that such changes in household circumstances are likely to disrupt cash flows, thereby eroding repayment capacity.

The relationship between default risk and excessive spending was inconclusive – even when controlling for ability to borrow. There was thus no evidence that delinquencies increased due to households spending excessively.

Given these results, it was concluded that South African households were more likely to experience repayment difficulties as a result of socio-economic shocks than excessive spending. The inference is that, delinquencies are still likely to occur even where appropriate risk evaluation measures have been applied if consumers are to be hit by financially adverse shock after agreeing to a credit contract. Although similar results have been found for households in the U.S. and Europe, for the current study, one cannot conclude with certainty that the level of indebtedness did not play any role in the delinquency as the data did not allow for a cross-reference between borrowing patterns and default risk and as the survey did not collect information on actual amounts borrowed.

Nonetheless, these results seem to suggest that current income and other proxies of income might not be enough to explain households' default risk and that lenders specialising in credit scoring systems might need to consider household situational factors as important determinants of repayment performance. The implications for consumers and social policy are clear: attach greater importance to precautionary savings.

The findings that unavoidable shocks are more important in debt repayment performances than excessive spending, means that even where responsible market practices are observed, there is a possibility that debt problems will still occur. As such, the implications for credit policy formulation are that over-indebtedness preventive regulatory tools (e.g., information and disclosure provisions) might not be enough to eradicate consumer debt problems. Given this scenario, and the adverse outcomes associated with over-indebtedness, it becomes imperative that the state implements well regulated mechanisms to relieve unfortunate consumers of their over-indebtedness in order to create an environment that can enable them to reclaim their financial health. The South African NCA provides for debt relief and the rehabilitation of consumers under its debt review and debt restructuring provisions. However, these are unlikely to provide meaningful relief and rehabilitation of over-indebtedness debtors due to their shortcomings discussed in Chapter 6.

7.1.3.2 Legal response to consumer debt problems.

As noted in Chapter 5 and the above subsection, the misfortunes that occasionally hit and adversely affect households' resources erode their capacities to manage their indebtedness even when they borrowed within their means. This means that while regulatory measures to prevent consumer over-indebtedness (pre-contractual regulations) might be useful, these should be complemented by even stronger alleviative regulations.

When consumers lose the capacity to continue paying their debts and have no prospects of doing so in the foreseeable future, it becomes a real possibility that they might also lose the capacity to continue earning a living if they are left to deal with the problem on their own. It then becomes the duty of the state to intervene and offer a helping hand in terms of discharging such over-indebtedness. While the design of the laws should be driven by social policy considerations (since individuals are the recipients), there are, however, common goals that have become the building blocks of contemporary debt relief regulatory regimes, including the need to reinvigorate individuals' productive potential; to reduce the social costs of leaving debtors in a state of perpetual over-indebtedness and to keep an appropriate balance between the consumers' duty to behave responsibly and affording unfortunate debtors a 'fresh start'.

In a context like South Africa, where household shocks are so rampant, often have long lasting effects on the victims and where most people cannot afford even the modest insurance against risk, it is imperative to have in place strong legal measures that can enable debt discharge for financially responsible debtors who lose the capacity to satisfy their obligations. This is made the more crucial by the fact that the current regulatory regime provides a number of modern preventive tools yet debt problems continue to rise.

The South African NCA provides for debt relief and rehabilitation of over-indebted consumers under its debt review and debt restructuring provisions 'based on the principle of satisfaction by the consumer of all responsible financial obligations'. Given recent developments in modern markets (on which South Africa continually benchmarks its consumer protection legal reforms), Chapter 6 of the dissertation attempted to provide an

understanding of why these measures are not up to the challenge of providing meaningful relief and rehabilitation to consumers who might need it.

7.1.3.2.1 The debt review process

As indicated in Chapter 6, the extent of the over-indebtedness problem and its consequences on households' socio-economic wellbeing had been noted in the policy document that preceded the NCA. It recommended legal measures that would provide for "some form of relief, other than more extreme measures such as debt administration" for over-indebted debtors (dti, 2004b:31). In response, the NCA introduced the provisions of debt review and debt restructuring (locally called 'debt counselling') which deal with relief and rehabilitation of over-indebtedness of natural persons. Under the law, an over-indebted debtor may apply to or may be referred to a debt counsellor to be evaluated and declared legally over-indebted (debt review), so that he/she may be relieved of his/her indebtedness by the court (debt restructuring). The relief provided entails re-arranging the payment schedules and reducing the amount of each payment due accordingly; and/or recalculating the consumer's obligations or discharge debts incurred as result of lender's recklessness.

While these provisions are a great improvement on what was on offer before and present some promise in terms of consumer protection, the dissertation noted in Chapter 6 that in its current form, the South African consumer debt relief regulatory framework has many weaknesses which make its capacity to offer meaningful relief rather questionable.

7.1.3.2.2 Shortcomings of the debt review process

While the dissertation recognised the idea that it is always better for policy to be context-specific, dealing with the over-indebtedness of natural persons might require certain basic standards – given the causes and effects of over-indebtedness. The empirical findings in chapter 5 on the drivers of over-indebtedness and the extant literature seem to suggest that there are more similarities across societies than differences. In addition, Chapter 6 identifies that due to the welfare implications of consumer over-indebtedness, recent developments and policy debates in many modern states suggest a move towards a convergence in regard to the principles that underlie an earned fresh start. This dissertation submitted that a number of aspects puts the debt review process off on a tangent in this regard. Thereby rendering the

process untenable and lagging far behind contemporary procedures offered in other modern markets. These shortcomings are identified in Chapter 6 as:

- Overlapping procedures (including the insolvency Act and Magistrates' Court Act) whose shortcomings necessitated the introduction of the debt review provisions in the first place.
- Inadequate legislation: no comprehensive, integrated and standardised system for consumer relief or rehabilitation.
- The lack of a clear, straightforward mechanism for debtor discharge.
- The absence of a complete discharge especially for those without any feasible income may perpetuate the over-indebtedness. They may yet default on the re-arrangement plans thereby worsening their positions.
- Other options, such as extending repayment periods may simply increase the over-indebtedness of many debtors rather than resolve it.
- Lack of clarity on important issues (e.g., the lack of time limitations on the procedures and the absence of regulations on closure) might limit the possibility of rehabilitation.
- There are no provisions for debtors who might have no income or assets with which to pay for the rearranged claims.
- The absence of special provisions with regards to secured creditors means that substantial debt (e.g., mortgages) might bloat the re-arrangement order thereby increasing the repayment-burden.
- No clear provisions on the operations and conducts of debt counsellors. Currently most of the procedures followed are those agreed upon under the Work Stream consultations. Also, the grade 12 minimum academic requirement for debt counsellors is too low.

- There is also a general lack of proper monitoring of compliance by the regulator (NCR).

Based on these shortcomings, it was submitted that the debt review provisions are not capable of providing meaningful relief to over-indebted debtors but rather very limited relief to some debtors who might still have the ability to repay the restructured agreements. Also, the absence of a clear, simple mechanism for debt discharge means that some debtors may find themselves even in worse positions under the procedure. In practice, the NCR's own investigations also uncovered various problems related to the above, including process weaknesses, a breakdown in role of and cooperation between players and abuse of practice, negligence and improper exercise of authority by debt counsellors. Given these shortcomings, the dissertation made recommendations for a complete review of these provisions.

7.1.3.3 Recommendations

This dissertation recommended a thorough review of the current measures in order to implement harmonised statutory debt relief procedures which incorporate the principles of rehabilitation, repayment, prevention of abuse and efficiency. In so doing, legislators should take stock of recent development in financially developed states and the international organisations' (e.g., UNCITRAL and World Bank) proposed standards of best practice with regards to dealing with debt problems of individuals; the causes and effects of over-indebtedness and the caveats of the current measures. In a nutshell, measures that are equal to the task of providing a real fresh start for unfortunate individual debtors.

- In terms of rehabilitation: provide for a simple mechanism for a fresh start through discharge of financially responsible individuals at the end of the proceedings (typically after 1 to 3 years). The terms of the discharge should be specific and simple; alternative measures for those who are unable to get a discharge should be clarified.
- With regards to repayment: the scope of assets and repayment plan should be clear (i.e., insolvency assets and size and type of exempt assets). Repayment terms should accurately reflect the debtor's capacity to repay with clear measures to deal with no-income/no-asset debtors.

- Prevention of abuse and efficiency: a comprehensive system with a unified and harmonised procedure, providing appropriate safeguards for creditor interests and clear perimeters for entry and closure of the process.
- Minimise the role of courts: regulate integrated amicable out-of-court processes; engage state sponsored local agencies; establish appropriate filing criteria; regulate mechanisms for post-insolvency debtor education and counselling.
- Devise separate means to deal with secured debt such as mortgages.
- Devise education agendas for consumers regarding their right and responsibilities, especially in workplaces as well as for debt counsellors.

On the basis of the empirical results on the cause of consumer debt problems (Chapter 5) and the literature on the causes and consequences of consumer over-indebtedness, the dissertation submitted that the ‘fresh start’ regulatory framework might even be more relevant to South Africa than the developed world.

7.1.3.4 Discussion

Chapter 5 of the dissertation presented some evidence on delinquency among South African households for the period 2005/2006. The key contribution was to discuss whether consumer debt problems were more likely to result from adverse household events or from overspending. It was noted from available literature that consumer debt delinquencies are often viewed as either the consequence of a genuine inability to repay when the household is hit by a financially adverse event or negative shock, or some households may be predisposed to arrears because of market practices that allow them to borrow excessively. Overall, the results in Chapter 5 were found to support the former argument, in the sense that the sampled consumers were more likely to be delinquent as a result of financially adverse events that possibly eroded their capacities to repay rather than because they consumed excessively. These findings were important contributions to South African consumer debt literature in the context of stimulating debate as to what areas of the consumer credit regulatory framework might require attention.

Chapter 5 concluded that while there might be safeguards to control borrowing and lending behaviours, it may not be possible to control whether households will suffer from unexpected negative events. For this reason, alleviating over-indebtedness becomes an important area of credit regulation. The idea is to have both preventive and alleviative measures complementing each other.

Chapter 6 analysed the current South African regulatory approach to alleviating consumer over-indebtedness in order to provide an understanding of why this approach is not equal to the challenge of achieving this purpose.

In South Africa, consumer over-indebtedness has mainly been attributed to reckless market practices, low levels of awareness, and a lack of enforcement, with very little (to no) recognition of the possibility that some consumers might borrow within their means and still find themselves facing repayment difficulties due the occurrences of unanticipated economic shock. This was perhaps the reason behind the NCA putting less emphasis of post-contractual consumer protection.

The NCA provides for debt restructuring, but this does not lead to a consumer discharge on simple, clarified conditions. Rather, it only provides for rescheduling of claims, and/or reduction of installment requirements. This is not good enough because, over-indebtedness often means a complete erosion of the repayment capacity. Rescheduling payments will not improve the debtor's situation unless he/she still has the capacity to repay. Other procedural flaws of the process also compromise any possibility of relief and rehabilitation. A comprehensive review of the current measures in favour of a tightly regulated consumer insolvency framework akin to the 'fresh start' regulatory mechanism was proposed.

7.2 Implications

7.2.1 Implications for regulation

Used wisely and in moderation, consumer debt can improve welfare, economic growth and is a major building block for a modern society. When households are able borrow and save, they can consume even without current incomes. Households are also able to withstand short-term shifts in income if they have access to credit. However, high levels of debt can be

damaging and often create severe vulnerabilities especially when families become less able to continue servicing their obligations as and when they come due. These vulnerabilities may be manifested in the inability to access future credit when needs arise, and/or inability to afford other life-cycle necessities such as rent, utilities or school fees. Beyond the household, when debt ratios rise beyond a certain level, financial crises become both more likely and more severe as has been noted by Reinhart and Rogoff (2009). Credit regulations are intended to prevent all these scenarios or to minimise their potential impact as much as possible. Drafters of consumer credit regulations need to take stock of the reasons why some consumers end up severely indebted than others. There are two factors: first, irresponsible lending and/or borrowing behaviours that render consumers financial overstretched. In this case, consumers – especially the more vulnerable (e.g., those on lower-incomes, unsteady employment, or new entrants to the job market) – would benefit from restricted access to consumer credit. Second, unfortunate (and often unanticipated) events that either interrupt consumers' income streams or disrupt their consumption plans forcing them to borrow more than they might afford or to abandon their obligations. In this regard, tighter legal relief interventions would be necessary.

The efficacy of the consumer debt regulations needs to be reviewed. While great strides have been made in the area of prevention of over-indebtedness (pre-consumption), with the emphasis on disclosure and information sharing, much more needs to be done. Common concerns emanate from the fact that currently not enough evidence to suggest that there is full compliance with the directives of the current legislation when parties enter into agreements, the evolving shape of credit regimes around the world, and the social pressures for excessive consumption especially among the new black middle classes which might compromise the capacity for capital accumulation. The regulator needs to take stock of these issues.

While evidence suggests that regulating information and disclosure increases access to credit especially among marginal borrowers, its impact on over-indebtedness of these groups, however, may not be so clear. It was noted in chapters 4 that the vulnerable groups experience

heavier debt-burdens, even though they only consume a small proportion of the debt and that some South Africans are taking debt into retirement. Protecting these marginal borrowers is especially crucial since many are unlikely to afford private insurance against risk. Therefore, first, it is imperative to implement an effective and orderly debt resolution framework that offers real relief and rehabilitation if responsible debtors lose the prospects of continuing to repay their obligations within a reasonable period of time. This protection should be provided through a simple, well regulated framework of debt discharge similar to the contemporary ‘fresh start’ idea. This is not to say that one size fits all, but there are common concerns and common lessons to be learnt. A modern state cannot regulate individual over-indebtedness in the same way as firms. When firms fail to pay their debt, they can be liquidated and can cease to exist. The same cannot be expected of households as they will still have to continue living and sustaining their dependents. Second, regulatory tools to influence acquisition of appropriate financial buffers, such as personal savings and insurance are necessary. Financial buffers might prove crucial in old age and in times of risk.

Credit information amnesties, such as the one recently implemented (forcing credit bureaux to expunging past adverse credit information of consumers), are not the solution. These disrupt the workings of the credit market as they are directly against the NCA’s objective of building mechanisms for effective risk assessment. These also have a potential to influence reckless lending as some people might borrow even when they lack the ability to do so.

7.2.2 Implications for education

Given that consumer debt participation and over-indebtedness are increasing in tandem, it is important to help consumers make better financial management choices. Experiences in the credit market show an emergence of a new breed of younger over-borrowers (especially from the ‘historically disadvantaged backgrounds’). They are often driven by conspicuous considerations and have little to no past experience of holding or managing money. These could benefit from a specifically tailored consumer education and counselling agenda. Although the NCR is making a concerted effort at public awareness, the efficacy of the education programmes need to be reviewed and new educational agendas for credit and financial management need to be developed. Financial literacy courses and courses looking

specifically at consumer credit and personal indebtedness should be made compulsory, starting from the lowest mainstream schooling level possible and further up to adult education levels.

Financial education courses and public information programmes need to be re-evaluated and developed with attention to the rich cultural diversity. Even though many people are using debt today, they might have grown up without any familiarity with the financial system due to South Africa's economic and political past. Such groups are especially vulnerable to predatory lending. Employers need to design training courses to help their employees to manage their money. This is especially important in low-wage industries and public institutions. Government employees are often targeted by lenders due to their high job security, then, debit orders and garnishee orders are placed on their salaries, thereby triggering complete life crises and extreme debt-to-income ratios. These could do with some compulsory money management training at work.

In terms of the more specific education themes: priority needs to be given to consumer rights and responsibilities under the credit law; how to build sufficient financial buffers; the potential risks of accumulating substantial debts and the importance of maintaining good credit histories so that they can be eligible for low-cost sources of credit whenever they need to borrow.

7.2.3 Implications for future research

As previously discussed, this study observed that financially adverse events play an important role in the decision to use consumer debt as well as the debt repayment performance. The majority of consumer financial studies emphasise precautionary savings as the tool for households to cope with risk. Research on survival without financial savings has been very limited. As such, future research needs to be more in-depth, in that researchers look beyond precautionary savings to understand how families who live on the edge cope with risk. A combination of quantitative research and qualitative research using focus groups should provide enough information on how people survive idiosyncratic shocks or what tools they might have in place to protect against these.

Also, this dissertation contends that, compared to the developed world contexts, shocks might be more important in the financial lives of individuals in contexts like South Africa, given the low saving rates, high unemployment rates, high dependence ratios, etcetera. However, there is as yet no South African study focusing mainly on household shocks. Future studies need to investigate the risk exposures of South African households and their risk-bearing capacities. Such a study should be useful in providing an understanding of the different areas for social investment that government and civil society need to explore under the revolving policy of consumer protection.

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Appendix A: Consumer protection in South Africa: an overview

The Consumer and Corporate Regulation Division (CCRD) of the DTI is responsible for all matters related to South African commercial, competition and consumer protection policies. Since the democratic elections in 1994 consumer protection has been one of the main policy objectives of regulating firms in South Africa and this is manifest in the numerous pieces of legislation. Some regulations are either merely incidental to consumer protection, whilst other measures are scattered in numerous statutes and policies.²⁰¹

Regulations to protect South African consumers have been scattered in the following statutes (among others): the Competition Act (Act No. 89 of 1998), which aims to promote and maintain competition to aid consumers in terms of product choice and competitive pricing; the Promotion of Access to Information Act (No. 2 of 2000), which deals with the right of access to information held by the state and/ or any other person required for the exercise or protection of constitutional rights; the Standards Act (No. 29 of 1993), dealing with promotion and maintenance of product quality and standards; certain sections of the Constitution pertaining to the Bill of Rights (sections 12, 16, 19, 24, 29 and 34); and the National Credit Act (No. 34 of 2005) which governs the granting and use of consumer debt and protects consumers from unfair credit practices, reckless credit granting and through relief from over-indebtedness.

Consumer protection laws were also buried in the now repealed Consumer Affairs (Unfair Business Practices Act No. 71 of 1982), which provided for the prohibition or control of unfair business practices which were contemplated to have a likelihood of harming relations between business and consumers or unreasonably prejudicing, deceiving or unfairly affecting any consumer. Others were the Trade Practices Act (No. 77 of 1973) which protected consumers against false or misleading advertisements; the Sale and Services Matters Act (No.

²⁰¹ The Green Paper on Consumer Protection (2004, page 23):
Available: <http://www.dti.gov.za/parliament/consumergaz.pdf>. [June 10, 2011].

25 of 1964), which regulated lay-by agreements, the display and marketing of goods and controlled and prohibited the sale of certain goods; and the Businesses Act (Act No. 71 of 1991), which regulated requirements pertaining to licensing and doing business generally.

There also exist a number of consumer protection institutions. While some of them only have advisory roles, others are mandated with industry specific regulatory powers. For instance, the National Credit regulator (NCR) established under the NCA to regulate the entire South African credit market; and the Consumer Affairs Committee²⁰² mandated to investigate and make recommendations to the Minister regarding business conduct considered harmful to consumers and recommends possible steps to be taken to regulate or eliminate such conduct. There are also Consumer Courts established with explicit powers to deliver judgment upon cases relating to unfair business practices. The South African Bureau of Standards (SABS), established in terms of the Standards Act, publishes standards and enforces product quality while monitoring compliance. The Competition Commission (34 Act No. 95 of 1998) deals with mergers and business practices contemplated to abuse market power as well as possible anti-competition practices.

There are also industry specific self-regulatory bodies set up and financially supported by businesses in similar or related trades such as the Furniture Traders' Association, the Advertising Standards Authority of South Africa and the Banking Association of South Africa. These represent interests of the industries they are attached to in such cases as labour negotiations, lobbying and parliamentary hearings as well as acting as conduits for customer queries and complaint.

In attempting to benchmark the current status of South African general consumer laws against international regulatory frameworks, the DTI proposed a comprehensive consumer protection legislation that clearly spells out the rights and obligations of all market participants. For that purpose, the DTI initiated a review of the consumer protection legislative measures and commissioned research that would support the development of a

²⁰² Reconstituted and renamed during amendments to the Harmful Business Practices Bill from the Business Practices Committee which was established in terms of the Consumer Affairs (Unfair Business Practices) Act (See the Harmful Business Practices Amendment Bill B138D - 1998).

new consumer protection policy. The objective was to establish a legal environment through which consumers would be granted rights that could be enforced and protected.²⁰³ A draft Green Paper on a consumer policy framework was published in 2004.²⁰⁴ This prepared the ground for the formulation of the consumer protection law (the Consumer Protection Act 68 of 2008) which was published in the Government Gazette (No. 32186) in April 2009 and became fully effective on 1 April 2011.

In making the case for the consolidated law, the 2004 Green Paper indicated that the then existing South African consumer protection measures were not well positioned to deal with emerging issues such as globalisation and e-commerce in light of consumer privacy and the provision of redress and enforcement because they were fragmented, outdated and spread across a myriad of industry specific statutes and the common law. This had resulted in 'uneven regulation, with heavy regulation in some areas and industries, but a reliance on self-regulation in most areas' (Government Gazette no. 26774, 2004).

The Consumer Protection Act was intended to revise old laws, codify the common law and combine existing and new consumer protection laws under a single organised system. This Act repealed some of those so-called outdated Acts, including, the Consumer Affairs Act; the Trade Practices Act; the Sale and Services Matters Act; and the Businesses Act; as well as the Price Control Act of 1964 and certain sections of the Merchandise Marks Act of 1941 which applies to all transactions occurring within South Africa involving the supply of goods or services, as well as to every advertisement transmitted or published in the course of business.

The Act's stated objectives include improving protection of consumers against unfair business practices, increasing fairness and equality among consumers and helping consumers make informed choices and improving consumer rights awareness, while making it easier for aggrieved consumers to get appropriate compensation or other forms of redress²⁰⁵. The

²⁰³dti, 2003. National Consumer Survey.

²⁰⁴Government Gazette No. 26774 (9 September 2004, pp 24).

²⁰⁵Consumer Protection Act (No. 68 of 2008): Government Gazette No. 32186 (29 April 2009) Vol. 526, Cape Town.

National Consumer Commission was also established under the Consumer Protection Act as the regulatory institution to protect consumers and ensure that consistent enforcement measures are adopted.

Appendix B: Macroeconomic effects on household delinquency

The importance of shocks in households' debt repayment performances observed from the household survey data prompted the need to triangulate with available macro-economic data to test how shock-related effects affect default losses of lending institutions. This was also necessary as some of the literature analysed, used macroeconomic data. This relationship was examined in an hierarchical OLS regression analysis with the impairment losses²⁰⁶ of two major lending institutions (ABSA and Standard Bank) for a 10-year period between 2000 and 2010 as the dependent variables, and trends in the unemployment rate during this period; a dummy variable for the recent economic crisis and the trends in the consumer price index (CPI) between 2000 and 2010 as independent variables – while controlling for households' disposable income between 2000 and 2010. The results of this triangulation exercise are presented in Table 12B below. The disposable income refused to enter the model for FNB and is therefore only present for Standard Bank.

While this study recognises the fact that unemployment in South Africa is essentially structural – in which case job losses would be a better indicator of a shock to the household concerned – the cyclical nature of the unemployment rate observed for this period (Figure 3B) makes this variable relatively useful in light of the objectives of chapter 5 of this dissertation. The consumer price index (CPI) was used because it reflects changes in the cost of living. The similarities in trends between annual impairment ratios of the two banks, the

²⁰⁶Impairment losses are defined as losses on delinquent loans for which the bank has objective evidence that they will not be able to collect the amount due. The dependent variable is total impairment loss ratio which refers to impairment losses on loans and other advances as a percentage of average loan advances to customers.

changes in the annual unemployment rate and the average annual consumer price index can be noticed in Figure 3B, below. Also evident is the sharp rise in impairment ratios for both banks for the period representing the recent economic crisis (between 2007 and 2009). These trends are intuitive in as far as shocks affecting income are concerned, and the volatility of consumers' aggregate repayment performances corresponds to these trends so that the aggregate repayment performance is seen to deteriorate during periods when consumer incomes are assumed to have been adversely affected, and the opposite seems true when household incomes were relatively robust.

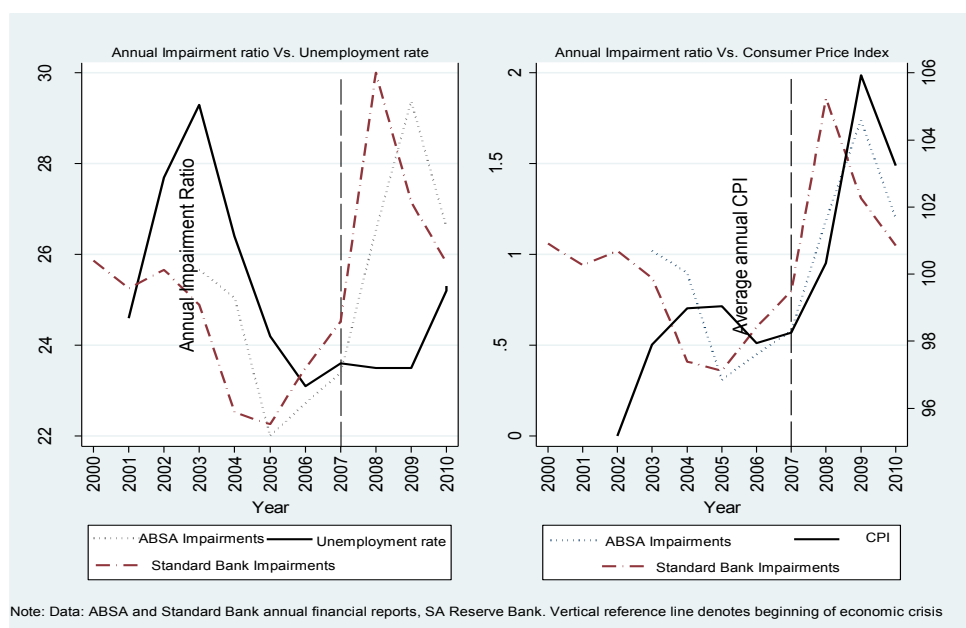


Figure 3B. Total annual impairment ratio Vs. Annual unemployment rate and Consumer price Index (CPI)

The OLS regression results in Table 12B below show that the unemployment rate and the recent economic crisis were positively associated with impairment losses incurred by both banks and were highly significant at the 5 per cent level. Although the CPI was highly significant in both cases, it was positive for ABSA Bank only but negative for Standard Bank. The average annual disposable income was significant and positively associated with impairment losses for Standard Bank. This could be interpreted to mean that households were incentivised to increase their willingness to borrow during the periods of rising income, and

possibly overextended themselves which might have resulted into repayment struggles. The same effect could be expected during times of low interest rates. These results bring forth an understanding that exogenous shocks over which households have little or no control will affect the household sector's debt repayment performances in the same way as individual-level shocks do (Chapter 5).

Table 12B. OLS regression for ABSA and Standard Bank impairment ratios

	Dependent variable: Annual impairment ratio (continuous)	
	ABSA Bank	Standard Bank
Unemployment rate	0.11** (0.03)	0.16*** (0.02)
Economic crisis	0.70** (0.16)	0.84*** (0.09)
Consumer Price Index	0.08** (0.02)	-0.10*** (0.01)
Disposable income		2.19*** (0.28)
Intercept	-10.11** (2.51)	-24.17*** (3.49)
<i>N (Years)</i>	8	9
<i>R</i> ²	0.922	0.982
Adjusted <i>R</i> ²	0.863	0.964
RMSE	0.174	0.089

Note: Standard errors in parenthesis *** p<0.01, ** p<0.05, * p<0.10

